# No Notice, No Examination, No Problem: IRS Further Deprives Appraisers of Procedural Protections

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**The IRS drastically and unilaterally changed its procedures for reviewing appraisals.**

It is no secret that the Internal Revenue Service ("IRS") loathes what it calls syndicated conservation easement transactions ("SCETs"). Valuations, of course, are the key to claiming many tax benefits, including deductions flowing from SCETs. The IRS has started to face challenges in attacking SCETs head on, so it has adopted an indirect approach centered on appraisals. Focusing on valuation is not problematic to most participants in SCETs; indeed, they welcome the chance to address substantive issues as opposed to defending against supposed technical flaws in the easement-related documentation.

However, many are now crying foul, as the IRS drastically and unilaterally changed its procedures for reviewing appraisals. It first issued a memorandum about Section 6695A penalties, which eliminated the multi-level review procedure formerly used by the IRS to safeguard appraisers against improper penalties and premature disciplinary referrals ("Interim Guidance Memo").[1] Next, the IRS appears to have ignored several suggestions from accounting and valuation organizations about potential problems. Doubling down on its initial position, the IRS most recently issued a Chief Counsel Advisory ("CCA") to its personnel further reducing appraiser rights and protections.

This article, which supplements and updates an earlier one, analyzes the main

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concepts around conservation easement donations, evolution of appraiser penalties, effects of the Interim Guidance Memo, disregarded suggestions from professional organizations, and the recent CCA further depriving appraisers of historical protections.[2]

## Overview of Conservation Easements

Taxpayers generally may deduct the value of any charitable contribution that they make during a year.[3] However, they are not entitled to deduct donations of property, if they consist of less than their entire interest in such property.[4] One important exception is that taxpayers can deduct a donation of a *partial* interest in property, provided that it constitutes a "qualified conservation contribution."[5] To meet this critical definition, taxpayers must show that they are permanently donating a qualified real property interest, to an appropriate organization, exclusively for conservation purposes.[6] This is commonly known as donating a conservation easement.[7]

Normally, a deduction for a charitable donation is allowed in the year in which it occurs.[8] If the donation consists of something other than money, then the amount is the fair market value ("FMV") of the property at the time the taxpayer makes the donation.[9] For these purposes, the term FMV ordinarily means the price on which a willing buyer and willing seller would agree, if neither party were obligated to participate in the transaction, and if both parties were to have reasonable knowledge of all the relevant facts.[10]

The IRS provides the following summary about valuation to its personnel in the relevant Audit Technique Guide ("ATG").[11] It explains that the best evidence of FMV of an easement is the sale price of other easements comparable to the easement in question, but "in most instances, there are no comparable easement sales."[12] Appraisers, therefore, often must resort to the before-and-after method. The ATG acknowledges that this effectively means that an appraiser must determine the highest and best use ("HBU") of the property, *and* the corresponding FMV of the property twice. First, the appraiser calculates the FMV if the property were put to its HBU, which generates the "before" value. Second, the appraiser identifies the FMV, taking into account the restrictions on the property imposed by the easement, which creates the "after" value.[13] The difference between the "before" and "after" value, with certain adjustments, produces the value of the easement donation.

As indicated in the preceding paragraph, in determining the FMV of property, appraisers must take into account not only the current use of the property, but also its HBU.[14] A property's HBU is the highest and most profitable use for which it is adaptable and needed, or likely to be needed, in the reasonably near future.[15] The term HBU has also been defined as the reasonably probable use of property that is physically possible, legally permissible, financially feasible, and maximally productive.[16] Importantly, valuation does not depend on whether the owner has actually put the property to its HBU yet.[17] The HBU can be *any* realistic potential use of the property.[18] Common HBUs are construction of a residential community, creation of a mixed-use development, mining the property, or developing a solar power facility.

Properly claiming the tax deduction triggered by an easement donation is surprisingly complicated. It involves a significant amount of actions and documents. The main ones are as follows: The taxpayer must (i) obtain a "qualified appraisal" from a "qualified appraiser," (ii) demonstrate that the easement-recipient is a "qualified organization," (iii) obtain a Baseline Report describing the condition of the property at the time of the donation and the reasons why it is worthy of protection, (iv) complete a Form 8283 (Noncash Charitable Contributions) and have it executed by all relevant parties, including the taxpayer, appraiser, and easement-recipient, (v) assuming that the taxpayer is a partnership, file a timely Form 1065 (U.S. Return of Partnership Income), enclosing the Form 8283 and qualified appraisal, (vi) receive from the easement-recipient a "contemporaneous written acknowledgement," both for the easement itself and for any endowment/stewardship fee donated to finance the perpetual protection of the property, and (vii) send all the partners their Schedule K-1 (Partner's Share of Income, Deductions, Credits, etc.) and a copy of the Form 8283.[19]

### Attacks on Partnerships

The IRS has been attacking partnerships for several years. This began when the IRS issued Notice 2017-10 in late 2016, labeling SCETs as "listed transactions."[20] This triggered the need for partnerships and others to file Forms 8886 (Reportable Transaction Disclosure Statement) and Forms 8918 (Material Advisor Disclosure Statement), providing the IRS lots of details that it utilizes in enforcement activities.[21] The aggression towards partnerships increased when the IRS later launched a "compliance campaign" centered on SCETs, devoting

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1 Tax Notes Doc. 2020-3440 (Jan. 22, 2020), consisting of LB&I-20-0120-001 (called the Interim Guidance on IRC 6695A Penalty Case Reviews).

2 This article supplements and updates an earlier one by the same author. Hale E. Sheppard, *Conservation Easement Enforcement: IRS Quietly Eliminates Procedural Protections for Appraisers*, 132(5) Journal of Taxation 17 (2020); republished in 31(6) Taxation of Exempts 13 (2020); and 47(4) Journal of Real Estate Taxation 19 (2020).

3 Section 170(a)(1); Treas. Reg. § 1.170A-1(a).

4 Section 170(f)(3)(A); Treas. Reg. § 1.170A-7(a)(1).

5 Section 170(f)(3)(B)(iii); Treas. Reg. § 1.170A-7(a)(5).

6 Section 170(h)(1).

7 Treas. Reg. § 1.170A–14(b)(2).

8 Section 170(a)(1).

9 Section 170(a)(1); Treas. Reg. § 1.170A-1(c)(1).

10 Treas. Reg. § 1.170A-1(c)(2).

11 Internal Revenue Service, Conservation Easement Audit Techniques Guide (Rev. 11/4/2016).

12 Internal Revenue Service, Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), pg. 41.

13 Id.

14 *Stanley Works & Subs. v. Commissioner*, 87 T.C. 389, 400 (1986); Treas. Reg. § 1.170A–14(h)(3)(i)and (ii).

15 *Olson v. United States*, 292 U.S. 246, 255 (1934).

16 *Esgar Corp. v. Commissioner*, 744 F.3d 648, 659 n.10 (10th Cir. 2014).

17 *Esgar Corp. v. Commissioner*, 744 F.3d 648, 657 (10th Cir. 2014).

18 *Symington v. Commissioner*, 87 T.C. 892, 896 (1986).

19 *See* Internal Revenue Service, Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), pgs. 24-30; IRS Publication 1771, Charitable Contributions – Substantiation and Disclosure Requirements; IRS Publication 526, Charitable Contributions; Section 170(f)(8); Section 170(f)(11); Treas. Reg. § 1.170A-13; Notice 2006-96; TD 9836.

dozens of specialized Revenue Agents and other IRS personnel to the cause.[22]

**Related Attacks on Appraisers**

The IRS is conducting a multi-faceted strategy, which entails confronting not only the partnerships that supposedly engaged in SCETs, but also parties that provided them services, such as appraisers. Legitimate scrutiny by the IRS of any group, including appraisers valuing conservation easement donations, is not problematic. However, concerns abound regarding the manner in which the IRS is carrying out its inquiries of appraisers and what it could mean to others outside the easement context. The critical events are discussed below.

**Section 170**

Section 170(a)(1) provides that a deduction for making a charitable donation will be allowed "only if verified under the regulations" issued by the IRS. The core problem was that the IRS did not issue regulations for many years. This absence of guidance, predictably, led to supposed abuses by taxpayers. The IRS expressed concern to Congress that donated property was being overvalued, taxpayers were playing the "audit lottery," and widespread publicity about noncompliance by donors and lax enforcement by the IRS was causing other taxpayers to disrespect the law.[23]

**Congressional Mandate in 1984**

Congress took action to strengthen substantiation requirements and curtail overvaluations. Instead of adhering to the traditional course of adding new tax provisions or modifying existing ones, Congress used a novel approach in the Deficit Reduction Act of 1984 ("DRA").[24] It simply referenced Section 170(a)(1), pointed out that the existing statutory language contemplated the IRS issuing regulations, and instructed the IRS to quickly do so, focusing on the concepts of qualified appraisers, qualified appraisals, and appraisal summaries.[25] In other words, Congress told the IRS to do its job, thank you very much.

The IRS issued temporary regulations by the end of 1984, as required by Congress in the DRA.[26] Among other things, the regulations stated that, in order to meet the definition of qualified appraiser, the person had to execute a declaration on the appraisal summary that he understood that "a false or fraudulent overstatement of the value of the property described in the qualified appraisal or appraisal summary may be subject to a civil penalty under Section 6701 for aiding and abetting an understatement of tax liability, and consequently the appraiser may have appraisals disregarded [pursuant to Circular 230]."[27]

As part of the DRA, Congress also expanded the rules that govern the behavior of tax professionals, commonly known as Circular 230. The DRA ensured that the Office of Professional Responsibility ("OPR") could punish not only misbehaving accountants and attorneys, but also appraisers.[28] Congress insisted on some limits, though, when it came to appraisers. The legislative history shows that while Congress generally wanted the OPR to have authority to regulate appraisers, it cautioned that punishment would be inappropriate, unless two things had occurred. First, the appraiser (i) knew that his appraisal would be used in connection with a tax return, (ii) knew the valuation was overstated, and (iii) thus knew that the appraisal would result in a tax understatement by the taxpayer. Second, the IRS had assessed a penalty against the appraiser under Section 6701 for aiding-and-abetting a tax understatement. The legislative history stated the following on this topic:

> The Secretary of the Treasury is authorized to bar from appearing before the [IRS] or Treasury Department, for the purpose of offering opinion evidence on the value of property or other assets, any individual against whom a civil penalty for aiding and abetting the understatement of tax (Sec. 6701) has been assessed. Thus, an appraiser who aids or abets in the preparation or presentation of an appraisal in connection with the tax laws will be subject to disciplinary action if the appraiser knows that the appraisal will be used in connection with the tax laws and will result in an understatement of the tax liability of another person. The Secretary is also given authority to provide that the appraisals of an appraiser who has been disciplined have not probative effect in any administrative proceeding before the Department of the Treasury or the [IRS].[29]

**Legislation in 2004**

In 2004, Congress enacted the American Jobs Creation Act, which created new Section 170(f)(11). This provision codified the regulations issued by the IRS two decades earlier, in 1984, regarding qualified appraisers, qualified appraisals, appraisal summaries, etc.[30] Congress also empowered the IRS to issue additional regulations, as necessary, to carry out the purposes of Section 170(f)(11).[31]

**Legislation in 2006**

Congress passed the Pension Protection Act ("PPA") in 2006. This legislation made two important changes when it came to appraisers, namely, it created a new penalty under Section 6695A, and it eliminated the need for the IRS to first assess an aiding-and-abetting penalty against an appraiser under Section 6701 before referring him to the OPR for potential disciplinary action. These two major changes are examined below.

***First Change – New Section 6695A Penalty***

Section 6695A provides that the IRS can assess a penalty if a person prepares an appraisal, such person knows or should have known that the appraisal would be used in connection with a tax return or a Claim for Refund, and the appraisal value results in one of several things, including a "gross valuation misstatement."[32] The penalty generally is the smaller of the following two items: (i) 10 percent of the amount of the tax underpayment, or $1,000, whichever amount is larger, or (ii) 125 percent of the gross income received by the person who prepared the appraisal.[33] The IRS will *not* assess the penalty, however, in situations where the appraiser can establish that the value in his appraisal was "more likely than not" correct.[34]

Section 6695A features some unique procedural aspects. For instance, the penalty does not supersede any other applicable penalties against an appraiser; rather, the IRS assesses it "in addition to any other penalties provided by law."[35] Moreover, the IRS generally has three years from the time that the taxpayer

filed the relevant tax return or Claim for Refund based on the appraisal to assess the penalty.[36] Finally, the normal deficiency procedures related to income and other taxes do *not* apply to these penalties, meaning that once the IRS assesses them, it immediately starts taking collection actions.[37] This limits the options available to penalized appraisers. They could pay the entire penalty up front, file a Claim for Refund, and then lodge a Suit for Refund in federal court, if the IRS either issues a Notice of Disallowance or ignores the Claim for Refund for more than six months. The alternative would be to wait for the IRS to send a "final" lien or levy notice, participate in a collection due process ("CDP") hearing with a Settlement Officer, and, if the IRS issues an unfavorable Notice of Determination, file a Petition with the Tax Court claiming that the IRS abused its administrative discretion, as granted by Congress, by failing to abate Section 6695A penalties.[38] Both options tend to be slow, uncertain, and expensive.

***Second Change – No Precursor to OPR Referrals.*** The legislative history *before* the PPA confirmed that the OPR could not sanction appraisers unless and until the IRS first examined an appraiser and assessed aiding-and-abetting penalties under Section 6701: "The [Treasury Department] also is authorized to bar from appearing before the [Treasury] Department, for the purpose of offering opinion evidence on the value of property or other assets, any individual against whom a civil penalty [under Section 6701] for aiding and abetting the understatement of tax has been assessed."[39] The language of Circular 230 *before* the PPA, likewise, required the imposition of aiding-and-abetting penalties as a prerequisite to disciplining appraisers: "Whenever the [OPR] is advised or becomes aware that a penalty has been assessed against an appraiser under Section 6701(a) of the Internal Revenue Code, the [OPR] may reprimand the appraiser or . . . institute a proceeding for disqualification of the appraiser."[40]

Things changed with the passage of the PPA. That law authorized the IRS to go straight to the OPR; that is, it no longer needed to first conduct an examination of the appraiser, prove intent of wrongdoing by such appraiser, and assess an aiding-and-abetting penalty under Section 6701. The legislative history to the PPA makes this short-circuiting clear: "The provision eliminates the requirement that the [IRS] assess against an appraiser the civil penalty [under Section 6701] for aiding and abetting the understatement of tax before such appraiser may be subject to disciplinary action. Thus, the [IRS] is authorized to discipline appraisers after notice and hearing."[41]

**Initial Concerns about Effects of PPA**

Practitioners quickly identified several concerns with the rules created by, and appraiser protections abolished by, the PPA.[42] First, the IRS promised to issue regulations clarifying Section 6695A issues approximately 15 years ago, but it has yet to do so, leaving taxpayers in the dark about key issues.[43] Second, practitioners were skeptical about whether the more-likely-than-not exception to the Section 6695A penalty had true functionality, pondering how the IRS or a court would accept the notion that the original appraisal was more-likely-than-not correct, when the ultimate value was so far off as to trigger a "gross valuation misstatement." Third, questions arose regarding the standard that the IRS would use for making disciplinary referrals to the OPR, emphasizing that Congress might have gone too far:

> The PPA may have tipped the balance between preventing abuse and discouraging [charitable] giving by eliminating the requirement that the [IRS] assess the civil penalty [under Section 6701] for aiding and abetting an understatement of tax *before* an appraiser may be suspended or barred from preparing or presenting appraisals for tax purposes. [Section 6695A] is somewhat worrisome, for without the prerequisite finding of willful misevaluation, it is unclear what standard will be used to make disciplinary decisions. Although enforcement of penalties against appraisers who knowingly exaggerate the value of donated assets is widely supported (even by appraisers), appraisers now risk losing the ability to practice their trade for making honest mistakes when appraising unique or otherwise hard-to-value assets.[44]

Fourth, commentators suggested that the threat of potential Section 6695A penalties, coupled with the IRS's broad authority to place appraisers in the crosshairs of the OPR, could lead appraisers to understate (as opposed to overstate) property values: "An unfortunate aspect of the new provision is that appraisers may feel coerced to 'back off' during an audit in order to avoid the penalty even if they sincerely believe that their appraisal accurately reflects value."[45] Finally, anxieties in-

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[20] IRS Notice 2017-10, 2017-4 Internal Revenue Bulletin 544 (Dec. 23, 2016). This covered both SCETs and other "substantially similar transactions."

[21] IRS Notice 2017-10, 2017-4 Internal Revenue Bulletin 544 (Dec. 23, 2016).

[22] IRS Information Release 2020-130 (June 25, 2020).

[23] U.S. Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, JCS-41-84 (Dec. 31, 1984), pgs. 503-504.

[24] Public Law 98-369.

[25] Public Law 98-369, Section 155(a); House Conference Report 98-861, 98th Cong., 2d Session (June 23, 1984).

[26] T.D. 8003 (Dec. 31, 1984); The regulations were later finalized in T.D. 8199 (May 5, 1988).

[27] T.D. 8003 (Dec. 3, 1984); Temp. Treas. Reg. § 1.170A-13T(c)(5)(i)(D)

[28] Public Law 98-369, Section 155(c).

[29] U.S. Joint Committee on Taxation. General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984. JCS-41-84 (Dec. 31, 1984), pg. 507.

[30] Public Law 108-357; Section 883 (Oct. 22, 2004); House Conference Report 108-755, 108th Cong., 2d. Sess., (Oct. 7, 2004), pgs. 745-747.

[31] Id.

[32] Section 6695A(a).

[33] Section 6695A(b).

[34] Section 6695A(c).

[35] Section 6696(a).

[36] Section 6696(d)(1).

[37] Section 6696(b).

[38] Section 6696(c). The Internal Revenue Manual indicates that appraisers might have certain post-assessment, pre-collection opportunities to seek reconsideration by the Appeals Office. *See* IRM § 20.1.12.10 (08-27-2010).

[39] U.S. Committee on Joint Taxation. "Technical Explanation of H.R. 4, the Pension Protection Act of 2006, as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006." JCX-38-06 (Aug. 3, 2006), pg. 310.

creased because of the power, held jointly by the IRS and the OPR, to ruin an appraiser's career with diminished procedural protections. Some parties expressed worries over the ability of the government to essentially "blacklist" appraisers.[46]

### IRS Issues Interim Guidance Memo in 2020

Another critical change with respect to appraisers occurred in January 2020, and almost nobody took notice initially. This might have been the intention of the IRS when it quietly released the Interim Guidance Memo that deprives appraisers of crucial procedural safeguards.[47] Because appraisals are pivotal in conservation easement cases, the Interim Guidance Memo acquires major importance in this context. Appreciating the changes triggered by the Interim Guidance Memo requires an understanding of the prior rules. A comparison of the old and new rules is set forth below.

### Procedures before the Interim Guidance Memo

The portion of the Internal Revenue Manual ("IRM") called "Referrals and Penalty Case Review Procedures" historically contained a multi-level review procedure designed to ensure that a particular degree of wrongdoing by the appraiser had occurred before the IRS assessed penalties, made referrals to the OPR, etc.[48] The IRM featured the unique procedures and terminology described below.

An Examining Appraiser (*i.e.*, an IRS Appraiser, Engineer, or Valuation Specialist) generally would recommend a Section 6695A penalty to the Revenue Agent, if the valuation reached the level of a "gross valuation misstatement."[49] To support this recommendation, the Examining Appraiser prepared a memorandum, including an explanation as to why the appraiser was incorrect and why he knew or should have known better.[50] Next, a so-called Penalty Review Team would analyze the recommendation and opine *before* the IRS could assess a Section 6695A penalty. The Penalty Review Team was comprised of "experienced" IRS Appraisers and Valuation Specialists, along with one or more Review Managers.[51]

The process used by the Penalty Review Team was as follows. The Review Manager assigned the case to a Primary Review Appraiser, who studied the original appraisal, reviewed the memorandum prepared by the Examining Appraiser in support of a Section 6695A penalty, determined if the penalty case should proceed, and reported this decision to the Review Manager.[52] If the Primary Review Appraiser recommended continuing the penalty case, then he assisted the Revenue Agent in preparing an Information Document Request ("IDR") for the appraiser requesting his grounds for meeting the more-likely-than-not exception to penalties. Next, the Revenue Agent and Primary Review Appraiser met with the appraiser to allow him the chance to discuss his responses to the IDR. If the Primary Review Appraiser concluded the penalties were appropriate after analyzing the IDR response and conducting the interview, then he prepared a memorandum for the Revenue Agent explaining why the exception was inapplicable. The Primary Review Appraiser would then forward the entire case file to the Review Manager.[53]

Continuing the belt-and-multiple-suspenders approach, if the Primary Review Appraiser wanted to assess the Section 6695A penalty, the Revenue Manager assigned a Secondary Review Appraiser. His role consisted of reviewing the entire file, including the memorandum drafted by the Primary Review Appraiser, preparing his own written analysis about the applicability of the penalty, and returning the case file, as augmented, to the Review Manager.[54] Finally (after obtaining and reviewing opinions about the Section 6695A penalty by the Revenue Agent, Examining Appraiser, Primary Review Appraiser, and Secondary Review Appraiser), the Review Manager prepared the "final concurrence" and forwarded the materials for inclusion in the workfile.

Before the issuance of the Interim Guidance Memo in 2020, the IRS would *not* assess Section 6695A penalties against an appraiser until the matter had been considered by at least five separate, experienced IRS employees.[55]

### Procedures after the Interim Guidance Memo

The IRS made its purpose in issuing the Interim Guidance Memo clear: "eliminating the multi-tiered review process for IRC 6695A appraiser penalty cases."[56] Under the Interim Guidance Memo, if an Examining Appraiser believes that there is a gross valuation misstatement while, say, auditing a conservation easement donation, he simply needs to get written approval from his immediate supervisor (with an e-mail sufficing) and then notify the Revenue Agent that the Section 6695A penalty might apply.[57] Moreover, the Interim Guidance Memo says that, while the decision to open a Section 6695A penalty case normally is based on the recommendation of an Examining Appraiser, Revenue Agents "should open" a penalty case "whenever they determine penalty consideration is warranted."[58] The Interim Guidance Memo goes on to explain that a Revenue Agent is only required to seek assistance, through the so-called Specialist Referral System, in situations where the Revenue Agent personally believes that he needs help.[59] Finally, the Interim Guidance Memo expressly states that the Revenue Agent is solely responsible for assessing the Section 6695A penalty based on information obtained during the examination, preparing the related report, and closing the penalty case.[60]

### Concerns about the Interim Guidance Memo

It did not take long for complaints and concerns about the Interim Guidance Memo to surface. This article summarizes several below.

#### Suggestions by Accounting Organization

The American Institute of Certified Public Accountants ("AICPA") sent a letter to the IRS Commissioner and other high-ranking tax officials.[61] The AICPA expressed its "disappointment" in the IRS for not giving advance warning of the Interim Guidance Memo to its "external partners," such as the AICPA. The letter goes on to explain that the AICPA supports the elimination of bad

actors, including appraisers who are untrained, inexperienced, and/or unreasonable.

However, the AICPA admonished that the Interim Guidance Memo could produce "negative unintended consequences." One possible result is Revenue Agents with little or no valuation experience starting Section 6695A penalty examinations that could permanently damage an appraiser's career. This is because many appraisers provide expert reports to, and serve as witnesses before, various tax agencies and courts. A good professional reputation is essential to fulfilling these roles. The AICPA points out that an opposing party in a dispute can obtain, via the discovery process, a copy of a Letter 4477 (Appraiser Appointment Letter) issued by the IRS to an appraiser. Therefore, even if the IRS never imposes a Section 6695A penalty, the mere fact that an examination occurred could undermine an appraiser's reputation, credibility and livelihood.

Another unexpected outcome is the departure of talent. The AICPA explained this potential phenomenon as follows: "The intent behind the IRS action to eliminate the tiered review was not to stop valuation professionals who are performing high-quality valuations; however, feedback received from [AICPA] members suggests if the IRS action is not revised, qualified experienced valuation analysts may cease performing tax valuations." The AICPA urged the IRS to reinstate the multi-level review procedure, which was in place before the release of the Interim Guidance Memo.

**Suggestions by Individual Appraiser.** An individual appraiser voiced his dislike of the Interim Guidance Memo via an article, making his point to the people instead of the tax administrators.[62] He explained that appraisers are a "key cog" in the conservation easement donation process, as they determine the value of the deduction in accordance with applicable tax laws and regulations. The appraiser predicted that the Interim Guidance Memo would lead to reduced land conservation, which is the opposite of what Congress has incentivized for decades. Describing the multi-level review procedure in effect before the Interim Guidance Memo, the appraiser said that it was fair, featured appropriate checks and balances, and guaranteed input from various valuation professionals. Adopting a more confrontational stance, the appraiser suggested that the Interim Guidance Memo is designed to "intimidate appraisers" and "discourage them from opining" on the value of conservation easements and other property rights, and constitutes a "unilateral" and "unprincipled" decision that deprives appraisers of due process. For these reasons, the appraiser, like the AICPA, urged the IRS to reinstate the earlier multi-level review procedure.

**Suggestions by Valuation Organizations**

A number of valuation organizations, writing jointly, also tried to get the attention of the IRS Commissioner.[63] This group maintained that the Interim Guidance Memo is contrary to the notions of due process and administrative restraint, and it places excessive control and responsibility in the hands of Revenue Agents with insufficient knowledge of valuation matters. The group anticipates that the Interim Guidance Memo will trigger a large number of unwarranted Section 6695A penalty cases, which likely will be fought bitterly. This is because a mere allegation by the IRS could "significantly impair" or "outright end" an appraiser's career. The group also criticized the manner in which the IRS dramatically changed matters: The IRS created the previous multi-level review procedure with "significant stakeholder input," but it announced the Interim Guidance Memo without warning. Unlike the AICPA and the individual appraiser discussed above, the group of valuation organizations did not seek reinstatement of the prior process. Instead, it broadly stated its desire to work collaboratively with the IRS to implement a new system that will focus on truly bad actors, while providing adequate due process and being mindful of limited IRS resources.

**Lawsuit by Certain Appraisers.** Three appraisers affected by Section 6695A penalties linked to valuations of conservation easement donations took a different approach. They filed a Complaint in District Court in April 2021 alleging that they, and other members of a larger class, had suffered damages as a result of the IRS's actions.[64] The Complaint alleges that the IRS improperly eliminated the multi-level review procedure by issuing the Interim Guidance Memo. It further argues that the IRS has implemented various tactics to intimidate, dissuade, or harass appraisers, including issuing Summonses requesting significant amounts of information that is already in the IRS's possession, sending notices warning that Revenue Agents

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40 Treasury Department, Circular No. 230 (Rev. 6-2005), 31 CFR § 10.60(b).

41 U.S. Committee on Joint Taxation. "Technical Explanation of H.R. 4, the Pension Protection Act of 2006, as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006." JCX-38-06 (Aug. 3, 2006), pg. 311.

42 *See, e.g.*, Janet A. Meade and C.J. Chiang, "Recent Judicial Guidance on Valuing Conservation Easements," 21(5) Taxation of Exempts March/April 2010; Suzanne Ross McDowell, " Charitable Contributions of Real Estate Interests," 35(1) Journal of Real Estate Taxation (2007); Robyn L. Dahlin and Alex R. Pederson, "The Pension Protection Act Encourages Charitable Giving with Some Caveats," 34(2) Journal of Real Estate Taxation (2007); Lance S. Hall, "Grim Tale of Aggressive IRS Enforcement," 16(5) Valuation Strategies May/June 2013.

43 IRSIG SBSE-04-0809-105 (Aug. 18, 2009).

44 Ruth M. Madrigal, "Charitable Giving Incentives and Reforms in the Pension Protection Act," 18(4) Taxation of Exempt Jan/Feb. 2007.

45 Diana S.C. Zeydel et al. "What Estate Planners Need to Know about the New Pension Protection Act," 105(4) Journal of Taxation (Oct. 2006).

46 Jonathan G. Blattmachr et al. Circular 230 Deskbook, Practising Law Institute, 2006, pgs. 2-28 and 2-29

47 Tax Notes Doc. 2020-3440 (Jan. 22, 2020), consisting of LB&I-20-0120-001.

48 IRM § 20.1.12.7 (12-18-2017).

49 IRM § 20.1.12.7 (12-18-2017); IRM § 20.1.12.7.2 (12-18-2017).

50 Id.

51 Id.

52 IRM § 20.1.12.7.4 (12-18-2017).

53 Id.

54 Id.

55 Id.

56 Tax Notes Doc. 2020-3440 (Jan. 22, 2020), consisting of LB&I-20-0120-001.

57 Id.

58 Id.

59 Id.

60 Id.

have authority to assert Section 6695A penalties, and threatening appraisers with immediate penalties if they refuse to "voluntarily" extend assessment periods. As one would expect, the government denied any wrongdoing and filed a Motion to Dismiss with the District Court, asking it to immediately dispense with the case.[65]

## Recent Chief Counsel Advisory – IRS Doubles Down

To understand the significance of a CCA issued in July 2021 about Section 6695A penalties, one must first review the relevant language in the current version of the IRM. The IRS inserted such language in the IRM, for all its personnel to review and follow, nearly two years *after* it published the Interim Guidance Memo, and *after* receiving all the comments described above from the AICPA, individual appraisers, and a group of valuation organizations.[66] The IRM warns all personnel to keep several objectives in mind when handling Section 6695A penalty cases, including that "[e]ach taxpayer should have the opportunity to have his or her interests heard and considered."[67] With respect to issue bifurcation, the IRM states that a Section 6695A penalty case "will be conducted as a separate and distinct case from the related tax examination."[68] The IRM provides details about the chronology, too, explaining that the IRS generally will not assert a Section 6695A penalty against an appraiser until after it has finished the related tax examination of the taxpayer.[69] The IRM goes on to emphasize that the IRS should not assert the Section 6695A penalty if the appraiser can establish that his appraisal value was "more likely than not" correct.[70] This cannot occur, of course, without the IRS first giving the appraiser an opportunity to present his side of the story.

The IRM contains considerable guidance regarding procedures. For example, it explains that if a Revenue Agent believes that a Section 669A penalty against an appraiser might be warranted, he must first submit a request to open an examination and obtain approval from his Group Manager.[71] Next, the Revenue Agent should send the appraiser a Letter 4477, thereby notifying him of the IRS scrutiny and scheduling a meeting.[72] The purpose of this initial meeting, according to the IRM, is to determine whether the appraiser meets the more-likely-than-not exception.[73] The IRM also indicates that the Revenue Agent "will make" appropriate contacts with third parties (*i.e.*, somebody other than the taxpayer or appraiser) in order to gather all relevant facts and determine the appropriateness of penalties.[74] If the Revenue Agent ultimately concludes that the appraiser deserves to be penalized, then he will prepare several documents, including a Form 886-A (Explanation of Items).[75] The IRM instructs Revenue Agents to state in Form 886-A the basis for asserting the penalty, why the more-likely-than-not exception does not apply, and the appraiser's position regarding the penalty.[76] Logic dictates that, before a Revenue Agent could meet these mandates, he would need to formally examine the appraiser, interview him, gather documents, consult with other parties with pertinent data, understand the defenses of the appraiser, and more.

With that backdrop, we now turn to the CCA issued by the IRS in July 2021, which surely will provoke additional concerns in the legal and valuation communities. The question presented in CCA 202129909 was whether a Revenue Agent could assess a Section 6695A penalty against an appraiser, *without* sending a Letter 4477 notifying him that he was under examination, *without* submitting to the appraiser even one IDR seeking data about the relevant appraisal, and *without* conducting an interview of the appraiser. The language in the CCA strongly implies that the Revenue Agent consulted the relevant portions of the IRM, described above, and was trying to gauge whether he must obey them. The CCA, presumably prepared by an IRS attorney in the Office of Chief Counsel, begins by telling the Revenue Agent that "the IRM is *not* legally binding on the IRS." The CCA continues by explaining that there is no case law or other guidance on the issue, but the IRS's position is that, while "it may be a good policy decision" to take the three actions before assessing the Section 6695A penalty, "the IRS is not legally required" to do so. The CCA also reasons that the more-likely-than-not exception to penalties, rooted in Section 6695A(c), is merely a defense that an appraiser can raise *after* being sanctioned, but it is "not a prerequisite to assessing it" in the first place. In other words, the CCA tells the Revenue Agent that he can simply ignore the potential exception, despite the fact that the IRM requires interviewing the appraiser and issuing him an IDR to determine whether he can meet the more-likely-than-not exception, and despite the fact that the Form 886-A must contain an explanation of why the exception is applicable. The CCA then concludes that as long as the Revenue Agent is able to establish the evidence necessary to meet the criteria in Section 6695A, then he can assess the penalty, *without* warning or directly engaging with the appraiser in any manner. Some might suggest that the CCA evokes a new motto for the IRS when it comes to appraiser scrutiny: no notice, no examination, no problem.

## Recent Tax Court Case

In a recent case involving a donation of a conservation easement, *Excelsior Aggregates, LLC v. Commissioner*, the partnership and the IRS filed Cross-Motions for Partial Summary Judgment on the issue of whether the IRS complied with Section 6751(b)(1) with respect to certain penalties.[77] This provision requires that the "initial determination" of a penalty assessment be personally approved, in writing, by a Revenue Agent's immediate supervisor. The IRS argued that it communicated the "initial determination" to the partnership in the notice of Final Partnership Administrative Adjustment ("FPAA") and that the supervisor had approved the penalties beforehand. The partnership had a different perspective, maintaining that the IRS made the "initial determination" four months before issuing the FPAA, when it assessed Section 6695A penalties against the appraiser who prepared the appraisal for the partnership.

The IRS conducted a penalty examination of the appraiser concurrently with the income tax examination of the

partnership. The IRS concluded, in January 2018, that the appraiser had made a "gross valuation misstatement" in connection with the conservation easement donation deduction claimed by the partnership and should suffer a Section 6695A penalty. The Revenue Agent conveyed this to the appraiser in January 2018 through a notice. Soon thereafter, in March 2018, the IRS formally assessed the penalty against the appraiser.

In June 2018, the Revenue Agent completed her examination of the partnership, deciding to disallow the deduction triggered by the conservation easement and to assert various alternative penalties, including one for a "gross valuation misstatement" under Section 6662(h). The Revenue Agent's supervisor digitally signed and approved the penalties against the partnership in July 2018, and the IRS issued the FPAA two days later.

The partnership suggested to the Tax Court that the Revenue Agent's decision to assess penalties under Section 6695A (for a gross valuation misstatement) against the appraiser constituted an "initial determination" of penalties under Section 6662(h) (for a gross valuation misstatement) against the partnership that used the appraisal in question. The partnership argued that because the Revenue Agent assessed Section 6695A penalties in March 2018, and because the Revenue Agent did not get supervisory approval for the Section 6662(h) penalties until July 2018, the Revenue Agent violated Section 6751(b), and the partnership should be free from penalties.

The Tax Court disagreed with the partnership's argument. Citing to earlier conservation easement cases, the Tax Court stated that "each penalty stands on its own" for purposes of Section 6751(b). It acknowledged that Section 6695A and Section 6662(h) "share a common element" in that they both require that a "gross valuation misstatement" occurred, but explained that "the imposition of [a Section 6695A] penalty against an appraiser does not automatically trigger a penalty against the taxpayer who relied on the appraisal."[78] The Tax Court went on to state that, in ascertaining whether penalty approval was timely obtained, the question is whether the Revenue Agent got permission from her direct superior before making the first formal communication "to the taxpayer" about the penalties. Therefore, explained the Tax Court, the issue turns on the timing of the communication to the taxpayer against which/whom the pertinent penalties are being asserted. The Tax Court recognized that the partnership likely maintained regular contact with the appraiser, and if the appraiser mentioned assessment of Section 6695A penalties against him personally, the partnership would have found this "a worrisome sign." Nonetheless, the IRS did not formally communicate the Section 6662(h) penalties to the partnership, in the FPAA, until two days after the Revenue Agent's supervisor had approved them in writing. Thus, the Tax Court concluded that the IRS did not violate the pre-notification supervisory approval obligation in Section 6751(b).

## Conclusion

When it comes to procedures applicable to appraisers, the IRS seems to be writing, or perhaps rewriting, its own rules as it goes along. The unilateral issuance of the Interim Guidance Memo in 2020, coupled with the CCA and Tax Court positions in 2021, will affect *all* taxpayers whose situations involve valuations, not just those associated with SCETs. Therefore, taxpayers involved in business sales, estate or gift tax issues, charitable giving and much more must remain vigilant of the radical changes in the IRS's treatment of appraisers and those who rely on them. ●

NOTES

61 "AICPA Concerned with Procedural Change for Appraiser Penalty Cases," 2020 Tax Notes Today Federal 119-27 (June 16, 2020).

62 Jeff Kauttu, "Conservation Easements at Risk Because of IRS Appraisal Penalties," 2020 Tax Notes Today Federal 155-8 (July 27, 2020).

63 "Valuation Professionals Tax Issue with Misstatement Penalty Provisions," 2020 Tax Notes Today Federal 122-22 (May 18, 2020). The letter was signed by the American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, Appraisal Institute, Appraisers Association of America, Association of Machinery and Equipment Appraisers, Equipment Appraisers Association of North America, International Society of Appraisers, Association for Valuation Professionals, National Association of Certified Valuators and Analysts, and National Association of Jewelry Appraisers, and Royal Institution of Chartered Surveyors.

64 "Conservation Easements Appraisers File Suit Against IRS," 2020 Tax Notes Today Federal 66-31 (April 2, 2021) (referencing *Benson et al v. Commissioner*, District Court Northern District of Georgia, Civil Action No. 2:21-cv-00074).

65 Kristen A. Parillo. "DOJ Urges Court to Dismiss Easement Appraiser Suit," 2021 Tax Notes Today Federal 196-5 (Oct. 13, 2021).

66 The relevant portion of the IRM was updated on October 6, 2021. It specifically references the Interim Guidance and the segments of the previous IRM that were "deleted due to the elimination of the multi-tiered review process." *See* IRM § 20.1.12 – Material Changes (10-06-2021).

67 IRM § 20.1.12.1.3 (10-06-2021).

68 Id.

69 IRM § 20.1.12.3 (10-06-2021). The exception to this rule being a situation where the assessment-period for the penalty will expire within six months.

70 IRM § 20.1.12.3 (10-06-2021).

71 IRM § 20.1.12.6 (10-06-2021). *See* Form 5345 (Examination Request-ERCS).

72 IRM § 20.1.12.6 (10-06-2021).

73 Id.

74 Id.

75 IRM § 20.1.12.6 (10-06-2021). Revenue Agents must also prepare and supply the appraiser Form 8278 (Assessment and Abatement of Miscellaneous Civil Penalties) and Letter 4485 (Appraiser Penalty Assessment Notification Letter).

76 IRM § 20.1.12.6 (10-06-2021).

77 *Excelsior Aggregates, LLC v. Commissioner*, T.C. Memo 2021-125.

78 This conclusion might make sense in the context of a "substantial valuation misstatement" under Section 6662(e), because Section 6664(c)(3) allows taxpayers to avoid such penalties if they can demonstrate that they relied on a qualified appraisal and made a good faith investigation of value. However, this conclusion becomes questionable when dealing with a "gross valuation misstatement" under Section 6662(h), because it does *not* permit any exceptions, excuses or justifications by the taxpayer to avoid penalties.