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Evaluating Three Conservation Easement Settlement Offers

by Hale E. Sheppard

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In this article, Sheppard explores the nuances of three IRS settlement programs relevant to syndicated conservation easement transactions.

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I. Introduction

It has been nearly a decade since the IRS started conducting widescale audits of what it now labels syndicated conservation easement transactions (SCETs). When that will end is far from clear, but what is apparent is that the IRS is eager to conclude as many cases as possible, and fast. Why? The IRS might be concerned about losing a major case on valuation issues before the Tax Court or Court of Appeals, which could unleash numerous future taxpayer victories. Another possibility is that the IRS wants to clear its inventory of existing SCET cases, believing they soon might not be problematic because of a new law limiting the size of charitable deductions.

Another motive might be that battling sophisticated taxpayers in high-dollar, complex, document-intensive cases is a drain on the IRS's resources. The true reasons for the IRS's desire to resolve SCET cases now is not especially important; what matters is understanding the relevant settlement programs and their nuances. This article compares three different IRS programs, identifying several open questions.[1]

II. Conservation Easement Donations: Overview

Congress first offered tax incentives for donating conservation easements in 1969.[2] It then codified the notion as section 170(h) in 1980.[3] Congress expanded the rewards for protecting land just four years later, mindful of increasing development pressures and decreasing federal budgets for land acquisition. A hearing about that legislation leaves no doubt that Congress was incentivizing private land preservation, and donors were motivated primarily by tax benefits.[4]

Valuation is a pivotal issue because it drives the size of the charitable tax deduction. The value of the conservation easement generally is its fair market value at the time of the donation.[5] FMV ordinarily means the price on which a willing buyer and willing seller would agree, with neither party being obligated to participate in the transaction and with both parties having reasonable knowledge of the relevant facts.[6] The best evidence of the FMV of an easement would be

[1]Hale E. Sheppard, "Conservation Easement Settlement Initiatives in 2020 and 2024," *Tax Notes Federal*, Mar. 25, 2024, p. 2355; Sheppard, "California's Settlement Initiative for Conservation Easements," *Tax Notes Federal*, July 24, 2024, p. 543; Sheppard, "Questions Remain About the Conservation Easement Settlement Initiative," *Tax Notes Federal*, Sept. 21, 2020, p. 2219; Sheppard, "Conservation Easement Settlement Initiative: More Guidance, More Questions," *Tax Notes Federal*, Nov. 16, 2020, p. 1085.

[2]Tax Reform Act of 1969, section 201; H.R. Rep. No. 91-782 (1969) (Conf. Rep.); *see also* Tax Reform Act of 1976, section 2124(e); *see also* Tax Reduction and Simplification Act of 1977, section 309.

[3]Tax Treatment Extension Act of 1980, section 6(a); S. Rep. No. 96-1007 (1980).

[4]Joint Committee on Taxation, "Description of S. 1675 (Public Land Acquisition Alternatives Act of 1983)," JCX-1-84, at 10 (Feb. 4, 1984) (statement by Senator Malcolm Wallop, R-Wyo.).

[5]Section 170(a)(1); reg. section 1.170A-1(c)(1).

[6]Reg. section 1.170A-1(c)(2).

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the sale price of other easements that are comparable in size, location, usage, etc. However, it is often difficult, if not impossible, to find comparable sales.[7] Thus, appraisers frequently must use the before-and-after method instead.

That means, broadly speaking, that an appraiser must determine the highest and best use of the property *and* the corresponding FMV twice. First, the appraiser calculates the FMV as if the property were put to its maximal use, 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.[8] The difference between the "before" value and "after" value, with some other adjustments, produces the value of the easement donation.

Claiming an easement-related tax deduction can be complicated. The process involves numerous actions and documents, including the following: The taxpayer must hold land that fulfills a particular "conservation purpose"; hire a "qualified appraiser" to produce a "qualified appraisal"; demonstrate that the party receiving the easement is a "qualified organization"; obtain an acceptable baseline report establishing the features of the land; receive a "contemporaneous written acknowledgement" of the donation; file a deed of conservation easement or the like; complete a Form 8283, "Noncash Charitable Contribution"; and submit a timely tax return reporting the event.[9]

III. Initial IRS Attacks and Solutions

The IRS started attacking so-called SCETs in late 2016, when it labeled them "listed transactions" and unleashed a compliance campaign.[10] The main allegation by the IRS was that SCETs often rely on appraisals that "greatly inflate the value of the conservation easement based on unreasonable conclusions about the development potential of the real property."[11] The compliance campaign triggered many audits, followed by Tax Court litigation.

The IRS first encouraged individual partners of partnerships that engaged in SCETs to resolve their issues by filing amended returns.[12] In other words, the IRS suggested that partners voluntarily retract all tax benefits that flowed to them from the partnerships. The IRS published an information release in late 2019 directing taxpayers to file amended returns, with insinuations of penalty mitigation in exchange for full concessions of tax benefits. The release contained the following advice:

> If you engaged in any questionable [SCET], you should immediately consult an independent, competent tax advisor to consider your best available options. It is always worthwhile to take advantage of various methods of getting back into compliance by correcting your tax returns before you hear from the IRS. . . . Taxpayers may avoid the imposition of penalties relating to improper contribution deductions if they fully remove the improper contribution and related tax benefits from their returns by timely filing a qualified amended return or timely administrative adjustment request.[13]

IV. First IRS Initiative — Docketed Cases Only

One early strategy by the IRS was to challenge all supposed "technical" problems with easements. It pounced on unintentional flaws with deeds of conservation easement, qualified appraisals, baseline reports, Forms 8283, and other documents. The Tax Court held in favor of the IRS on several technical issues, resulting in charitable deductions of $0 and large penalties.[14]

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[7] IRS, "Conservation Easement Audit Techniques Guide," at 41 (rev. Nov. 4, 2016).

[8] *Id.*

[9] *See id.*, at 24-30; IRS Publication 1771, "Charitable Contributions — Substantiation and Disclosure Requirements," (Mar. 2016); IRS Publication 526, "Charitable Contributions" (2022); section 170(f)(8); section 170(f)(11); reg. section 1.170A-13; Notice 2006-96, 2006-2 C.B. 902; T.D. 9836.

[10] Notice 2017-10, 2017-4 IRB 544, preamble and section 1.

[11] *Id.*, at section 1.

[12] Reg. section 1.6664-2(c). For more information about qualified amended returns, *see* Sheppard, "Conservation Easements, Partners, and Qualified Amended Returns?" *Tax Notes Federal*, Jan. 20, 2020, p. 373.

[13] IR-2019-182; *see also* IR-2019-213.

[14] *See, e.g.*, *Railroad Holdings LLC v. Commissioner*, T.C. Memo. 2020-22; *Oakhill Woods LLC v. Commissioner*, T.C. Memo. 2020-24; *Oakbrook Land Holdings LLC v. Commissioner*, T.C. Memo. 2020-54; *Woodland Property Holdings LLC v. Commissioner*, T.C. Memo. 2020-55; and *Coal Property Holdings LLC v. Commissioner*, 153 T.C. 126 (2019).

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Riding the momentum from those early victories, the IRS announced a proposed solution in June 2020: the first settlement initiative.

The IRS originally described the terms of the first settlement initiative by issuing a news release and then sending offer letters to eligible partnerships.[15] It later clarified matters by releasing a chief counsel notice and a second news release.[16] Details follow.

A. Which Transactions Were Affected?

The first settlement initiative applied to both SCETs *and* "substantially similar transactions," including some donations of property in fee simple.

B. Were All Partnerships Eligible?

The first settlement initiative applied only to cases that were already docketed with the Tax Court; that is, those cases for which petitions had been filed. Stated another way, it did not apply to partnerships that donated an easement but were not yet under audit, partnerships under audit, or partnerships awaiting review by the Appeals Office directly after an IRS audit.

C. Did All Partners Have to Settle?

The first settlement initiative generally was open only to partnerships in which *all* partners agreed to concede. However, the offer letters ambiguously stated:

> The IRS may consider offers to resolve cases on terms similar to those contained herein where fewer than all partners in the partnership agree to enter into the settlement. In such cases, the IRS may revise certain terms, including, for example, by requiring a *greater penalty* than the penalty required under the [First] Settlement Initiative.

The chief counsel notice later explained that the IRS might consider settling with just a group of partners as long as that group represented a "significant percentage" of all the ownership interests in the partnership, absolutely all partners in the partnership waived their right to a consistent agreement with the IRS, and the group fully cooperated with the IRS.[17]

While resolution without unanimity was possible, it triggered a less favorable result for those partners who opted to participate in the first settlement initiative. The chief counsel notice explained that those participating "must agree to the applicable increased penalty rate," which was 5 percent above the normal rate.[18] For example, if a partner acquired an interest in a partnership that engaged in an SCET with a return-on-investment ratio of 4.5 to 1, the penalty under the first settlement initiative would increase from 10 percent to 15 percent.[19]

D. What if Investigations Were Underway?

The first settlement initiative ordinarily was not available to any partnership in which one or more partners was under criminal investigation, yet the offer letters vaguely explained that "the IRS might consider offers from the partners in such a partnership who were not under criminal investigation to resolve the case on terms similar to those contained herein."

E. Were All Partners Treated the Same?

All partners were *not* created equal, at least according to the IRS. The offer letters described two categories of partners, who received disparate treatment under the first settlement initiative.

Category one partners were those who engaged in any of the following activities or who met any of the following criteria: (1) organized or participated, directly or indirectly, in the sale or promotion of any SCET; (2) received fees for organizing, selling, or promoting any SCET; (3) received fees for providing an appraisal for any SCET; (4) received fees for providing legal advice or tax advice for any SCET; (5) received fees for tax return preparation services (including both signing preparers and nonsigning preparers) for any SCET; (6) was a "material adviser" for any

[15] IR-2020-130.

[16] CC-2021-001; IR-2020-228.

[17] CC-2021-001, Q&A B(2).

[18] *Id.* at Q&A B(3).

[19] *Id.* at Q&A B(3) and C(7)(b).

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SCET; (7) was a partner in a partnership or was an employee of an entity that engaged in any of the activities listed above; or (8) was "related" to any of the persons who engaged in any of the activities listed above. To be clear, although the IRS proposed to resolve matters on a partnership-by-partnership basis, partners had to consider *all* their past behavior, for *all* partnerships, to determine whether they would be category one partners.

By default, category two partners were those who were *not* category one partners.

F. What Were the Costs?

The costs of resolving matters under the first settlement initiative had three parts.

1. Taxes.

Under the first settlement initiative, the partnership could not deduct, under section 170 or any other tax provision, any portion of the amount it originally claimed on its tax return for the SCET. Likewise, partners could not deduct any portion of the amount claimed by the partnership that flowed through to them.

The partnership was obligated to pay the federal income tax liability for each partner for each year affected by the SCET, calculated as follows. Category one partners could not claim any deduction for contributions of cash or other property to participate in an SCET. In other words, they obtained a charitable deduction of $0 and essentially lost their investment in the partnership.

By contrast, category two partners generally could claim an ordinary tax deduction equal to the out-of-pocket costs paid to participate in the SCET, which included both cash and other property contributed in exchange for partnership interests.

2. Penalties.

The first settlement initiative contemplated accuracy-related penalties. For category one partners, the sanction was the highest penalty asserted by the IRS, either in the notice of final partnership administrative adjustment or by the IRS attorneys later during Tax Court litigation. Generally, that was the 40 percent penalty for "gross valuation misstatement," but the civil fraud penalty of 75 percent sometimes appeared.

Regarding category two partners, the penalty was based on one of three percentages, depending on the return-on-investment ratio. First, if the partner claimed a charitable deduction that was between one and five times his investment in the partnership that engaged — directly or indirectly — in the SCET, the penalty was 10 percent of the tax underpayment. Second, if the partner claimed a deduction that was between 5.1 times and eight times his investment in the partnership, the penalty was 15 percent of the tax underpayment. Third, if the partner claimed a deduction that was more than 8.1 times his investment, the penalty rose to 20 percent.

The first settlement initiative envisioned further penalties when Forms 8886, "Reportable Transaction Disclosure Statement," were not submitted to the IRS. The partnership had to provide evidence that it and all its partners filed timely and proper Forms 8886. If any party failed to do so, the settlement would include a penalty under section 6707A. For listed transactions, like SCETs, the maximum penalty for individual partners was $100,000, while the maximum for entities was $200,000.

3. Interest.

The partnership had to aggregate and pay interest for all partners for all affected years on both the tax liabilities and penalties.

G. When Was Payment Due?

The entire amount (including taxes, penalties, and interest) was due before or when the partnership and its partners submitted to the IRS executed closing agreements (that is, Forms 906).

H. Was Full Payment Required?

The chief counsel notice indicated that the partnership, or group of participating partners, had to pay the full settlement amount when they executed the closing agreement with the IRS.[20]

I. Who Signed Closing Agreements?

The offer letters said that the partnership as well as "all direct and indirect partners" had to execute closing agreements. What did that mean?

[20] *Id*. at Q&A F(1).

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It is common in SCETs for individual partners to purchase interests in one partnership, which, in turn, makes a capital contribution to the partnership that owns the land and donates the conservation easement. The offer letters indicated that all partners, at all levels, were obligated to execute closing agreements.

J. Did Participation End All Problems?

The offer letters stated that participation in the first settlement initiative would not have an effect, limitation, or prohibition against the IRS on later asserting criminal penalties, promoter penalties, appraiser penalties, return preparer penalties, etc. The chief counsel notice, for its part, admonished that executing a closing agreement did "not preclude the IRS from investigating any associated criminal conduct or recommending prosecution for violation of any criminal statute."[21]

K. Was Cooperation Required?

The partnership and all its partners had to "fully cooperate" with the IRS during the settlement process, which included providing all requested additional information. Cooperation in this scenario encompassed supplying correspondence, e-mails, communications, and other documentation exchanged between the participating partners and (1) the partnership; (2) other partners; (3) agents or representatives of the partnership; (4) organizers, promoters, or proponents; (5) appraisers, engineers, or others involved with valuing the property; (6) tax return preparers; and (7) tax advisers.[22]

L. Was There Any Flexibility?

The chief counsel notice indicated that the partnership and all participating partners must ultimately memorialize their participation in the first settlement initiative by executing a closing agreement with the IRS and executing a decision document for the Tax Court.[23] It vanquished any thoughts about personalizing terms with the IRS based on unique circumstances. The chief counsel notice explained that "no provision of either document [was] subject to negotiation."[24]

V. Second Initiative — Docketed Cases Only

The first settlement offer from the IRS disappeared in early 2021, presumably because of low participation levels.[25]

Circumstances changed after closure of the first settlement offer. After the Tax Court held that the IRS had violated the Administrative Procedure Act when it issued the notice years ago calling SCETs "listed transactions," the IRS issued proposed regulations in December 2022 to rectify matters.[26] They provide that if promotional materials pledge that economic returns to partners might meet or exceed 2.5 times their capital contributions and satisfy other criteria, an easement donation will be an SCET and various duties and potential penalties will apply.[27]

Another major change was that Congress introduced a new easement law.[28] The SECURE Act 2.0 of 2022 added a standard for donations, section 170(h)(7), which applies to transactions taking place in 2023 or later. That provision generally states that a partnership will not be entitled to any tax deduction if the amount of the conservation easement donation exceeds 2.5 times the total "relevant basis" of the partners in the partnership.[29] Congress created three carve-outs to this new rule.[30]

Another novel circumstance was a change in IRS leadership. The new IRS commissioner announced from the outset he would focus on "transforming" how the IRS functions and

[21] *Id.* at Q&A D(2); section 7121(b); reg. section 301.7121-1(c).

[22] CC-2021-001, Q&A D(1)(b).

[23] *Id.* at Q&A E(1)(a).

[24] *Id.*

[25] Kristen A. Parillo, "IRS Expands Easement Settlements to Nondocketed Cases," *Tax Notes Federal*, July 1, 2024, p. 111 (indicating that "few settlements were reached because of the program's restrictive terms and conditions").

[26] REG-106134-22; IRS Announcement 2022-28, 2022-52 IRB 659; Joseph DiSciullo, "Proposed Regs Require Reporting of Conservation Easement Deals," *Tax Notes Federal*, Dec. 12, 2022, p. 1565.

[27] REG-106134-22, at 19.

[28] The SECURE Act 2.0 is a component of the Consolidated Appropriation Act, 2023.

[29] The SECURE Act 2.0, section 605(a)(1), new section 170(h)(7)(A). The rules apply to subchapter S corporations and other passthrough entities in the same manner as they do to partnerships. *See* Secure Act 2.0, section 605(b), new section 170(h)(7)(F).

[30] SECURE Act 2.0, section 605(a)(1), new section 170(h)(7)(C), (D), and (E).

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address emerging compliance issues, such as improper employee retention credit claims.[31] Conservation easement issues, which largely developed before his time, did not top the priority list.

One final change worth noting was the growing backlog of cases in the Tax Court that resulted from COVID delays, inadequate staffing, large numbers of pending cases filed by taxpayers involved in SCETs, and other factors.[32]

The four circumstances noted above, and perhaps others, led the IRS to launch another program for SCETs in early 2024 (the second settlement initiative). It did not broadcast the approach through news releases, announcements, or the like. Instead, the IRS began sending letters to SCET cases pending with the Tax Court, meaning that the second settlement initiative, just like the first settlement initiative, was limited to partnerships with "docketed" cases.[33]

A. Settlement Basics

The main terms of the second settlement initiative are as follows. The IRS effectively forces partners to pretend they donated cash to the Red Cross or another legitimate charity, as opposed to making capital contributions to the SCET partnership. For example, assume that a partner made a capital contribution of $100,000 to a partnership and expected to receive a charitable donation tax deduction of $500,000. Under the second settlement initiative, the partner essentially must recalculate his income tax liability for all relevant years, benefitting from a total deduction of only $100,000.[34] This represents a decrease of $400,000. The decline likely would result in significant federal income taxes for the partner, presumably over multiple years.

The IRS would then impose a penalty equal to 10 percent of the total federal income tax liability after removing $400,000 in deductions, as described above.

Lastly, the IRS would impose interest charges on not only the federal income taxes but also the 10 percent penalty. The interest charges would be retroactive in the sense that they started running years ago. If the conservation easement donation occurred in 2018, for instance, the interest started accruing against an individual partner back on April 15, 2019.

B. Inducements From the IRS's Perspective

Taxpayers might struggle to grasp what the IRS believes is the lure here; that is, what does the IRS believe it is yielding to entice pretrial settlements? At least four things come to mind. First, the second settlement initiative allows partners to claim a tax deduction equal to the capital contributions they made to the partnerships. The capital contributions, made by the partners, tend to be higher than the acquisition price, paid by the partnerships to obtain the land on which they ultimately placed easements. That is because due diligence costs, professional fees, commissions, insurance premiums, and other predonation amounts normally get paid out of the capital contributions. The primary position by the IRS in many recent Tax Court cases is that the property-acquisition price is the best indicator of value.[35] Thus, the IRS views its willingness to link the tax deductions to the capital contributions as an act of generosity.

Second, the second settlement initiative does not decrease the overall easement value by applying the "after" value to the analysis.

Third, instead of threatening partners with a penalty of 10, 15, or 20 percent based on their expected rate of return, a penalty of 40 percent for a gross valuation misstatement, or a penalty of 75 percent in instances of fraud, the second

[31] *See, e.g.*, IR-2023-45; Testimony of IRS Commissioner Daniel Werfel before the House Appropriations Committee on IRS operations and funding (June 3, 2013); IRS conference spending (June 6, 2013); improvements in IRS operations (Sept. 18, 2013); IRS operations (Oct. 24, 2023).

[32] "Appeals Memo Outlines Steps to Shrink Tax Court Case Backlog," 2022 *Tax Practice Expert* 22-14 (May 30, 2022); Joel G. Cohen, "IRS Appeals Has a Solution to Its Tax Court Backlog," *Tax Notes Federal*, June 6, 2022, p. 1587; Nathan J. Richman, "Appeals Learned Some Things While Clearing Docketed Case Backlog," *Tax Notes Federal*, Mar. 13, 2023, p. 1805 (explaining that the Appeals Office cleared about 7,500 pending Tax Court cases in 2022 alone).

[33] The author has dozens of these letters on file.

[34] Section 67(a) generally states that an individual taxpayer can claim itemized deductions only to the extent that the total exceeds 2 percent of their adjusted gross income. The settlement offers from the IRS indicate that this limitation will not apply in these circumstances.

[35] *See, e.g.*, *Glade Creek Partners, LLC v. Commissioner*, T.C. Memo. 2023-82; *Mill Road 36 Henry LLC v. Commissioner*, T.C. Memo. 2023-129; *Oconee Landing Property LLC v. Commissioner*, T.C. Memo. 2024-25; *Savannah Shoals LLC v. Commissioner*, T.C. Memo. 2024-35; *Buckelew Farm LLC v. Commissioner*, T.C. Memo. 2024-52; and *Excelsior Aggregates LLC v. Commissioner*, T.C. Memo. 2024-60.

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settlement initiative features a standard sanction of 10 percent. The universality of that 10 percent penalty is important; it indicates that all partners get it, regardless of what they anticipated to glean from their investment or their role in past, present, or future SCETs.

Finally, the letters from the IRS issued as part of the second settlement initiative do not demand that the partnership pay the entire liability (comprising taxes, penalties, and interest) at the time it signs a decision document. One might surmise, therefore, that the IRS intends to collect the liabilities later, from the partners, pursuant to the applicable procedures. One also might infer that the partners can negotiate a payment plan, called an installment agreement, or a settlement agreement, known as an offer in compromise, if their financial situations warrant it.

VI. Third Initiative — Nondocketed Cases Only

The IRS, in its zeal to dispense with as many SCETs as possible before trial, introduced in late June 2024 yet another possible manner to resolve matters (the third settlement initiative).[36] This occurred while the second settlement initiative was still in effect, with the IRS still sending letters for that program to partnerships whose cases were already in Tax Court. The IRS explained, somewhat obtusely, that partnerships eligible for the second settlement initiative would *not* get a shot at the third settlement initiative, stating that "taxpayers with cases pending in the United States Tax Court are not eligible."[37]

The IRS's announcement about the third settlement initiative was vague. It stated that the IRS would be mailing "time-limited" offers to taxpayers that participated in SCETs or "substantially similar transactions" and currently find themselves under audit. However, the IRS did not specify the settlement terms, indicating merely that resolution would require a "substantial concession of the income tax benefits and the application of penalties."[38] The IRS also neglected to clarify whether the third settlement initiative would be directed at partners or partnerships.

The announcement then inserted some veiled threats, among them that "the IRS has consistently disallowed the tax benefits" claimed by taxpayers, SCETs have appeared on the Dirty Dozen list multiple times, the IRS has successfully challenged valuation in several recent cases, nearly a dozen people have been found guilty of crimes involving SCETs, and Congress recently passed the SECURE Act 2.0 "to help curb SCET abuse" in 2023 and onward.

After setting that tone, the IRS "encouraged" taxpayers and their advisers to carefully consider resolving matters through the third settlement initiative because it, from the IRS's perspective, is the "most effective and efficient way to bring finality" to the situation.[39]

A. Why Offer Another Settlement?

The letters from the IRS showcase its rationale. As one would expect when a party is trying to persuade its opponent to surrender without a fight, the IRS displayed extreme confidence, combined with some one-sided claims, as follows:

> We've litigated and won [SCET] cases for failures to meet [technical] requirements and overvaluation of the conservation easement. Penalties asserted by the [IRS] have been sustained. The U.S. tax court and appellate courts have issued opinions favorable to the IRS in [SCET] cases where the true value of the easement was found to be a small fraction of the claimed value. We expect we'll continue to prevail in [SCET] litigation. However, we're offering to resolve your transaction now in the interest of sound tax administration and considering recent legislation.

B. What Do You Call This Thing?

Partnerships began receiving letters less than two weeks after the IRS's announcement. They started with some branding, with the IRS calling the third settlement initiative the "2024

[36] IR-2024-174; *see also* Parillo, *supra* note 25.

[37] IR-2024-174.

[38] *Id.*

[39] *Id.*

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Syndicated Easement (Nondocketed) Resolution."

C. Who Can Participate?

The IRS letters say the third settlement initiative "is being offered to the [partnership] listed above and is *not* available to partners on an individual basis." As explained above, the announcement expressly stated that the IRS would direct letters only to partnerships with "non-docketed" cases; that is, those SCETs or substantially similar transactions that are currently under IRS audit and not yet in Tax Court.

D. What Types of Partnerships Are Relevant?

The letters indicate that various types of partnerships might participate in the third settlement initiative. These include partnership cases through 2017 subject to the procedures derived from the Tax Equity and Fiscal Responsibility Act (TEFRA cases); cases through 2017 not controlled by the special procedures (non-TEFRA cases); cases in 2018 forward governed by the rules established by the Bipartisan Budget Act (BBA cases); and cases in 2018 and later years that chose not to adhere to the normal rules (BBA elect-out cases).

E. How Do Partnerships Participate?

The letters indicate that the so-called authorized signer must elect to participate in the third settlement initiative within 30 calendar days of the date of the letters. That person varies, depending on the type of partnership. The tax matters partner is the authorized signer for TEFRA cases, the partnership representative is the authorized signer when it comes to BBA cases, and all partners constitute the authorized signer in situations involving non-TEFRA cases or BBA elect-out cases.

Making the election to resolve matters through the third settlement initiative requires the authorized signer to take several actions within the 30-day period, among them providing a copy of the relevant Form 1065, "U.S. Return of Partnership Income," granting the IRS an adequate extension of the assessment period, and initialing or executing the offer letter in several spots.

The letters state that the IRS will interpret an "election" as a "non-binding consent" by the partnership to participate. That suggests that initially electing to participate in the third settlement initiative does not necessarily mean a partnership ultimately will resolve issues in this manner. The letters clarify that things are not done until later, after the partnership and IRS execute a closing agreement, the partnership makes full payment, etc.

F. What Are the Terms?

The terms of the third settlement initiative resemble those of the second settlement initiative in that the partnerships will get a charitable tax deduction of $0 but will be entitled to claim a deduction for "out-of-pocket costs." The IRS defines this as the total estimated amount that partners paid, likely in the form of capital contributions, to either the partnership that donated the conservation easement or an investment-tier partnership.

The IRS changed things up, though, in two ways. First, the letters indicate that the IRS will calculate the tax liability, at the partnership level, using a tax rate of just 21 percent. Taxes previously depended on the federal income tax rate to which each individual partner was subject during the relevant years. That was often the maximum of 37 percent. Second, the letters state that the IRS will only impose a penalty equal to 5 percent of the resulting federal income tax liability. The penalty in the second settlement initiative was double that, at 10 percent.

Unsurprisingly, the letters confirm that the IRS will demand interest on both the taxes and penalties under the third settlement initiative. That figure will be calculated through 30 days after the IRS sends the closing agreement to the partnership to conclude matters.

G. Will the IRS Haggle?

The letters emphasize that the third settlement initiative is a take-it-or-leave-it situation because the IRS "will not entertain counteroffers."

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H. What Are the Payment Details?

The partnerships that donated the conservation easement, not their direct or indirect partners, are obligated to pay the IRS. The letters clarify, moreover, that BBA cases cannot try to reduce or jettison the partnership-level liability by applying to modify an "imputed payment" or by making a "push-out election."

The letters demand that the partnerships make a one-time payment of all the taxes, penalties, and interest due under the third settlement initiative. To put it another way, the letters leave no doubt that the IRS, at least at this time, is not considering installment agreements, offers in compromise, or other payment alternatives.

Full payment is not due when the authorized signer makes an "election" to participate within 30 days of the date of the letter from the IRS. Rather, the partnerships must pay before or when they and their partners submit the executed closing agreements to the IRS.

I. What if Prior Deposits Were Made?

The fact that some partners previously made "deposits" with the IRS under section 6603 to halt the accrual of interest does not diminish the total payment due by the partnerships under the third settlement initiative. The letters explain that, when prior deposits occurred, partnerships still must pay the entire amount due, and then the relevant partners can seek refunds of the deposits pursuant to the procedures in Rev. Proc. 2005-18.

J. Must All Partners Participate?

The letters says that, when it comes to TEFRA partnerships, "all partners must participate in the resolution." They further explain that the partnerships, through their tax matters partners, "all direct partners," and spouses of all direct partners if they filed joint Forms 1040, must execute closing agreements with the IRS.

Regarding BBA partnerships, the IRS letters say that the partnership representative can make the election to participate in the settlement and that the subsequent closing agreement needs to be executed only by the partnership representative and any individual who has power to bind the partnership under state law. Thus, in theory, the partnership representative essentially is in charge of decision-making about the settlement for BBA partnerships.

However, the settlement requires full payment (of taxes, penalties, and interest) by the partnership, and that usually cannot occur unless (1) all partners remit to the partnership their share of the taxes, penalties, and interest or (2) most of the partners pay their share and the partnership has some other way of covering the financial shortfall. Therefore, in practice, participation in the settlement by BBA partnerships requires agreement by all, or nearly all, the partners.

K. What Level of Cooperation Is Required?

The letters make it clear that participating in the third settlement initiative requires more than just signing and paying; the IRS demands cooperation, too. For example, the letters state that "the partnership and the partners" must "fully cooperate" with the IRS. The letters, likely anticipating some foot-dragging by participants during the process, explain that cooperation includes "providing additional information requested by the IRS" and "meeting stringent deadlines."

The letters also warn that if partnerships or their partners "take steps inconsistent with facilitating resolution" under the third settlement initiative, the IRS will "remove" them, and that decision cannot be challenged.

L. Does Participation Halt All IRS Actions?

The letters contain details about what participation in the third settlement initiative, including executing a closing agreement and making full payment, does *not* mean. The letters clarify that the IRS can still assert promoter penalties under section 6700, appraiser penalties under section 6695, return preparer penalties under section 6694, or pursue discipline under the Circle 230 rules enforced by the Office of Professional Responsibility. The letters further state that the IRS is still free to conduct criminal investigations of entities or individuals that assisted or advised others in participating in SCETs.

On a related note, the letters affirm that participation does not mean the IRS agrees that the deduction allowed under the third settlement

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initiative (that is, the out-of-pocket costs by partners) constitutes the true value of the relevant property or easement or that no civil fraud occurred.

VII. Conclusion

This article shows that SCET disputes are fluid; things can change swiftly and dramatically. It also demonstrates that recent IRS actions have triggered several questions. Will partnerships with docketed cases participate in the second settlement initiative when they know that partnerships with nondocketed cases are now receiving offers to resolve matters under the third settlement initiative on arguably better terms? Will the IRS decide to grant both docketed and nondocketed cases the chance to settle on the terms found in the third settlement initiative? If the IRS cannot expand eligibility for the third settlement initiative, will it later accept "qualified offers" from partnerships with docketed cases that feature settlement terms identical to those in the third settlement initiative?

Will the IRS recognize that achieving participation by all partners is impractical or impossible in many instances, follow the path it previously did with the first settlement initiative, and allow resolution under the third settlement initiative with less than unanimity? Will the IRS realize that demanding full payment at the partnership level under the third settlement initiative will make participation unworkable for many partnerships and accept payment at the partner level consistent with the second settlement initiative? Will the introduction of the second settlement initiative and third settlement initiative backfire on the IRS, with taxpayers heading toward litigation in droves because, despite its strong public stance, the IRS lacks the necessary resources to litigate large numbers of SCET cases?

Taxpayers in easement disputes with the IRS will be watching eagerly for answers to those and many other questions. ■

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