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Conservation Easements
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CIRCUIT COURTS SPEAK ON CONSERVATION EASEMENTS, BUT IS THE IRS LISTENING?

The Service's reaction to, and the Tax Court's subsequent narrow interpretation of, two decisions has done much to cool taxpayer enthusiasm.

***35** *Kaufman v. Shulman*, 687 F.3d 21, 110 AFTR2d 2012-5278 (CA-1, 2012), and *Scheidelman*, 682 F.3d 189, 109 AFTR2d 2012-2536 (CA-2, 2012), are the two most recent cases brought before the federal courts of appeals involving key conservation easement issues. In each case, the courts rendered taxpayer victories on threshold technical issues. The *Kaufman* and *Scheidelman* decisions are welcome developments in conservation easement jurisprudence. In each, the appellate court found that the IRS and the Tax Court went too far in their narrow interpretation of conservation easement compliance and substantiation rules. Unfortunately, the Service's reaction to, and Tax Court's subsequent narrow interpretation of, these decisions has done much to cool taxpayer enthusiasm.

Describing a prior taxpayer victory in the D.C. Circuit, [FN1] the authors noted that, notwithstanding the court's affirmation that substantial compliance applies in conservation easement cases, the Service had continued to pursue the most technical of challenges. As the following discussion describes, the authors are seeing a similar IRS reaction to the *Kaufman* and *Scheidelman* decisions.

Kaufman¶axpayer wins the battle but the war rages on

The highly anticipated First Circuit opinion in *Kaufman* originated in the Tax Court. [FN2] The court held that a façade easement granted by taxpayers on a historic row house was not protected in perpetuity, and thus was not a qualified conservation contribution. The holding was based on language contained in a subordination agreement between the mortgagee of the property and the preservation trust.

Kaufman in the Tax Court.

The central issue in *Kaufman* originally was whether the taxpayers properly subordinated the outstanding mortgage on their eased property, as required in applicable statutory and regulatory provisions. [FN3] In accordance with Reg. 1.170A-14(g)(2) , the taxpayers obtained a subordination agreement from the mortgagee that seemed to satisfy the subordination regulation. However, a particular clause in the subordination agreement lead the Tax Court to determine the subordination was not sufficient, creating a potentially far-reaching problem for the conservation easement community.

The subordination agreement at issue in *Kaufman* contained the following language:

> ***36** The Mortgagee/Lender and its assignees shall have a prior claim to all insurance proceeds as a result of

any casualty, hazard or accident occurring to or about the Property and all proceeds of condemnation, and shall be entitled to same in preference to Grantee until the Mortgage is paid off and discharged, notwithstanding that the Mortgage is subordinate in priority to the [Preservation Restriction] Agreement. [FN4]

Pursuant to the subordination agreement, the mortgagee subordinated its rights under the mortgage to those of the easement holder but for the quoted reservation. The taxpayers (as would many in the conservation easement community) believed that they had satisfied Reg. 1.170A-14(g)(2) , which simply states that “no deduction will be permitted under this section for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity.”

The IRS, however, argued that the lender improperly reserved priority over any condemnation or insurance proceeds. According to the IRS, this violated another provision in the regulations that addresses allocation of proceeds upon the extinguishment of the easement. In particular, Reg. 1.170A-14(g)(6)(ii) provides, in part:

[F]or a deduction to be allowed under this section, at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time. See)1.170A-14(h)(3)(iii) relating to the allocation of basis. For purposes of this paragraph (g)(6)(ii), thatproportionate value of the donee's property rights shall remain constant. Accordingly, when a change in conditions give [sic] rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(i) of this section, the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.

Because the “proceeds clause” in the *Kaufman* subordination agreement gave the bank first priority over condemnation and insurance proceeds, Judge James Halpern held that the clause violated Reg 1.170A-14(g)(6)(ii). He reasoned that the division of proceeds regulation mandated that the preservation trust be guaranteed a proportionate share of future proceeds and that the mortgagee cannot have an absolute preference over the proceeds.

On appeal, the taxpayer argued that the Tax Court had commingled two independent regulations to create a requirement for easements over mortgaged property that had never before existed. The new requirement was that the mortgage, in addition to being subordinated to the easement, would have to provide for a proportionate sharing of proceeds from any condemnation or other extinguishment of the easement between the mortgage holder and the preservation trust. Moreover, although the Tax Court's Summary Judgment Order was not clear, it seemed to indicate that a donee organization must be “entitled” to such proceeds, in the sense of having an “absolute right” to its proportionate share of such proceeds over all third parties. As explained by the First Circuit, such a rule, when taken to its logical conclusion, would have a draconian effect on easement contributions.

Based on its interpretation of Reg 1.170A-14(g)(6), the Tax Court granted summary judgment to the IRS on the division of proceeds issue, but held that a genuine issue of material fact existed as to other issues. [FN5] In a second opinion, after trial on the remaining issues, the Tax Court reaffirmed its ruling on the division of proceeds issue. [FN6] The taxpayers appealed.

Kaufman on appeal.

The First Circuit analyzed the extinguishment, subordination, and division of proceeds provisions of Reg. 1.170A-14(g) . It concluded that the Tax Court relied entirely on Reg. 1.170A-14(g)(6) , the division of proceeds provision, to deny the taxpayers' deduction. Acknowledging that paragraph (g)(6) was not explained when first promulgated, the court reasoned ***37** that it "appears designed in case of extinguishment both (1) to prevent taxpayers from reaping a windfall if the property is destroyed or condemned and they get the proceeds from insurance or condemnation and (2) to assure that the donee organization can use its proportionate share of the proceeds to advance the cause of historic preservation elsewhere." [FN7]

The Tax Court's decision was summarized by the First Circuit as follows:

> [A]lthough the Kaufmans in the Preservation Restriction Agreement ... granted the Trust an entitlement to a proportionate share of post-extinguishment proceeds, thus seemingly complying with the regulation, the lender agreement executed by Washington Mutual undercut this commitment—and so defeated the deduction—by stipulating that "[t]he Mortgagee/Lender and its assignees shall have a prior claim to all insurance proceeds ... and all proceeds of condemnation, and shall be entitled to same in preference to Grantee until the Mortgage is paid off and discharged." [FN8]

The First Circuit then rejected the Service's position as adopted by the Tax Court, in large part on policy grounds. First, the court observed that the taxpayers had no control over what the mortgagee would and would not agree to. Taking this rationale a step further, the court noted that subordination of certain other liens, such as municipal tax liens, are completely out of the taxpayers' control. The court reasoned:

> Certainly the IRS has good reason to assure that the Kaufmans could not recapture the value of what they gave up by granting the easement in order to get the deduction; but the Kaufmans had no power to make the mortgage-holding bank give up its own protection against fire or condemnation and, more striking, no power to defeat tax liens that the city might use to reach the same insurance proceeds—tax liens being superior to most prior claims. [FN9]

The court went on to scrutinize the Service's interpretation of the word "entitled" found in Reg. 1.170A-14(g)(6) , providing that the word does not mean "gets the first bite" as against the rest of the world. Instead, a "grant that is absolute against the owner-donor is also an entitlement." [FN10] In the final counterargument to the Service's position, the court reasoned that, "given the ubiquity of superiority for all tax liens, the IRS's reading of its regulation would appear to doom practically all donations of easements, which is surely contrary to the purpose of Congress." [FN11] Accordingly, the court determined that Reg. 1.170A-14(g)(6) does not require the donee organization to be guaranteed first priority to its share of insurance and condemnation proceeds.

The First Circuit then turned to an unrelated, technical argument made by the Service pertaining to the perpetuity requirement of Section 170(h)(5)(A). Specifically, the Service argued that because the agreement between the taxpayers and the trust contained the provision that "nothing herein contained shall be construed to limit the [trust's] right to give its consent (e.g., to changes in the Façade) or to abandon some or all of its rights hereunder," the trust had a "blank check" to consent to any type of change, even changes that were inconsistent with the easement. [FN12] Therefore, the Service argued, Reg. 1.170A-14(g)(1) , requiring enforceable restrictions that will prevent uses of the retained interest (i.e. the interest not granted to the trust) inconsistent with the conservation purposes of the donation, was violated.

The court cited the D.C. Circuit's rejection of the same argument in *Simmons*, 646 F.3d 6, 10, 107 AFTR2d 2011-2632 (CA-D.C., 2011), *aff'g* TCM 2009-208. The First Circuit agreed with the D.C. Circuit that such a

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clause has no significant effect on the perpetuity of the easement. A change might be necessary to allow a charitable organization to accommodate changed conditions, but the agreement ensured that any changes would be consistent with the conservation purposes of the easement.

The IRS also argued that the regulation was a “reasonable interpretation” of Section 170(h)(5), and should be given deference. The court rejected this argument, concluding, “Yet the question here is not whether paragraph (g)(1) is reasonable, but whether the Service's *interpretation* of that regulation is reasonable.” [FN13] The court concluded that it was not. [FN14]

The First Circuit next turned to the Service's arguments concerning substantiation, recordkeeping, and reporting requirements. The bulk of these arguments turned on the completion of the appraisal summary, IRS Form 8283, which taxpayers must complete in connection with a donation. The Service identified elements of the Form 8283 that were in fact incomplete, such as the manner and date of acquisition of the donated property and the cost or other basis of the property contributed. The taxpayers argued, however, and the court agreed, that they did not “acquire” the façade easement and had no “cost or other basis” to report. [FN15] The court noted that technically the taxpayers should have written “None” or “N/A” in the space provided, but just as it was decided in *Scheidelman*, [FN16] these “defects” were not nearly egregious enough to doom the appraisal summary.

After finding in favor of the taxpayers on the “proceeds” issues, the issue concerning the ***38** trust's rights to “abandon” or amend the easement, and the “record keeping and reporting” requirements, the First Circuit went a step further, providing guidance to the Tax Court, the Kaufmans, and taxpayers generally. Specifically, the court addressed issues concerning the value of the easement (issues not technically before it). The court went to great lengths to describe how certain evidence indicated the façade easement had been overvalued. Moreover, the court described how penalties (civil and criminal) might be appropriate in certain situations.

Perhaps the First Circuit's view of the case, of conservation easements generally, and of the way the Service has zealously challenged technical issues is best summarized in the last paragraphs of the court's opinion, in which it states:

> To reject overly aggressive IRS interpretations of existing regulations is hardly to disarm the IRS. Without stifling Congress' aim to encourage legitimate easements, one can imagine IRS regulations that require appraisers to be functionally independent of donee organizations, curtail dubious deductions in historic districts where local regulations already protect against alterations, and require more specific market-sale based information to support any deduction. Forward looking regulations also serve to give fair warning to taxpayers.
>
> If taxpayers still do not get the message, the penalties regime is formidable, *see, e.g.,* 26U.S.C.)6662(h)(l) (40 percent penalty for gross valuation misstatements); and, for willful abusers, there are criminal penalties, *e.g.,* 26 U.S.C.)7201 (prison term up to five years). The Justice Department has already secured a permanent injunction against the trust to prohibit some of the practices alluded to in this case. [FN17] The IRS is properly zealous to protect the revenues and over the long run it has been given tools to do so.

Accordingly, although the First Circuit denied the Service a swift victory based on technical arguments, the court was not hesitant to express its opinion regarding potential abuses in the easement arena and the potential overvaluation of the facade easement at issue before the court.

Kaufman¶he fallout.

Under the “Golsen Rule,” [FN18] the Tax Court follows decisions of the court of appeals to which a case is appealable. Conversely, the Tax Court will not necessarily follow decisions of a circuit court of appeals—e.g.,

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the First Circuit—when an appeal will be to another circuit—e.g., the Second Circuit. However, the IRS can and sometimes does acquiesce to certain appellate court decisions, stating that it will apply a particular circuit court ruling in all circuits.

Considering the Service's aggressive positions in previous easement cases, there is much pessimism in the easement community that the IRS will acquiesce in the First Circuit's opinion in *Kaufman.* In fact, the IRS recently declined the opportunity to do so in *Mount*, Docket No. 17390-09, a New York case that is appealable to the Second Circuit. In that case, the IRS filed a response conceding that the taxpayer satisfied Reg. 1.170A-14(g)(6) , but it based its concession on a narrower basis than *Kaufman*, relying instead on an interpretation of New York state law. [FN19]

Based on the Service's narrow concession in *Mount*, as well as its failure to acquiesce in recent taxpayer-friendly rulings in the circuit courts, one can anticipate continued controversy in this area. Indeed, the IRS has informally stated that it would not apply the *Kaufman* decision in other circuits. Moreover, as is demonstrated in *Scheidelman* (discussed below), the Tax Court has shown little inclination ***39** to alter its positions any more than required under the Golsen Rule.

Scheidelman—How much is enough?

Scheidelman is one of the more significant recent taxpayer victories in the easement area. Although its primary holding is based on the specific facts in the case, the decision provides an interesting perspective on how the conservation easement rules may be applied by the courts and on how they should be applied by the Service.

Scheidelman in the Tax Court.

Scheidelman, TCM. 2010-151, involved a taxpayer who donated a façade conservation easement to the National Architectural Trust (NAT) in 2004. In connection with the donation, the taxpayer received an appraisal from Michael Drazner. Drazner determined the value of the façade easement by applying what he considered to be the “before and after” approach, in which the fair market value of the building is determined before and after it is encumbered by the façade easement, the difference being the value of the preservation easement. Importantly, when determining the “after value” of the building, he applied a percentage discount (11.3%) to the “before value,” determining that the building had decreased by that amount as a result of the easement. Explaining why an 11.3% diminution was appropriate, Drazner noted that the “conclusion is based on consideration of range of value that the IRS has historically found to be acceptable as well as historical precedents.” [FN20]

In the Tax Court, the Service asserted that the taxpayer failed to obtain a “qualified appraisal” of the donated façade easement, thereby violating Section 170(f)(11). Specifically, the IRS argued that the taxpayer's appraisal insufficiently explained the method and basis of valuation, and thereby failed to comply with Reg. 1.170A-13(c)(3)(ii) . [FN21] Regs. 1.170A-13(c)(3)(ii)(J) and (K) require the appraiser to provide the “method of valuation to determine fair market value” and the “specific basis for the valuation, such as specific comparable sales transactions or statistical sampling,” respectively. The Service argued, in the alternative, that the taxpayer failed to fully complete the Form 8283 (Appraisal Summary), by omitting the property acquisition information on the form. [FN22]

The taxpayer proposed three arguments as to why she satisfied the “qualified appraisal” requirement. First, she argued that her appraisal clearly specified the “method of valuation” it used—the “before and after” method.

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She pointed out that the before and after method of appraising easements had been repeatedly accepted by the courts, and that percentage reductions, in particular, had been accepted as a qualified methodology. Second, she argued in the alternative that, even if Dazner's appraisal was not qualified, her failure to obtain a "qualified appraisal" was due to reasonable cause, citing Section 170(f)(11)(A)(ii)(II). Finally, she argued that she was entitled to a deduction because she "substantially complied" with the appraisal regulations. [FN23]

The Tax Court agreed with the Service that the appraisal lacked a method of valuation because "the application of a percentage to the fair market value before conveyance of the façade easement, without explanation, cannot constitute a method of valuation." [FN24] Accordingly, the Tax Court determined that the taxpayer failed to obtain a "qualified appraisal," as required under Section 170(f)(11). With respect to the taxpayer's argument that she had reasonable cause for failing to provide a qualified appraisal, the Tax Court summarily dismissed the argument by stating "Petitioners have not persuaded us that reasonable cause existed and excuses the failure to comply with the requirements for obtaining a qualified appraisal." [FN25]

The Tax Court next turned to the question of whether the taxpayer "substantially complied" with the qualified appraisal requirement. The court noted that the "critical question was whether the requirements at issue relate 'to the substance or essence of the statute,"' in which case substantial compliance was not applicable, as opposed to "procedural or directory" requirements. Ultimately, the court determined that the lack of a recognized methodology or specific basis for the calculated after-donation value was "too significant for [the court] to ignore under the guise of substantial compliance." [FN26]

In connection with granting the façade easement, the taxpayer also made a payment to NAT in the amount of $9,275. Although the taxpayer did not initially deduct the amount as a contribution on her 2004 tax return, the deductibility of this payment was tried by consent of the parties in the Tax Court. The Service alleged that the payment was not a "contribution or a gift" under Section 170, but was rather a "quid pro quo" because NAT accepted the easement and assisted the taxpayer in claiming a tax deduction in return for the payment, which ***40** was calculated as a percentage of the valuation of the easement. The Tax Court determined that the taxpayer was not entitled to a deduction of the cash donation because the taxpayer "failed to provide evidence necessary for [the court] to determine that in return for the payment of cash [the taxpayer] received nothing of substantial value...." [FN27]

Scheidelman on appeal.

The Second Circuit reversed the Tax Court's determination that the taxpayer failed to substantiate the value of the donated preservation easement with a "qualified appraisal." The Second Circuit determined that the appraisal was sufficient for purposes of the Code, holding that "the regulation requires only that the appraiser identify the valuation method 'used'; it does not require that the method adopted be reliable. By providing the information required by the regulation, [the appraiser] enabled the IRS to evaluate his methodology." [FN28] In fact, the court noted, the appraiser expressly selected the before and after method. [FN29] In so holding, the court observed, "[The appraiser] did in fact explain at some length how he arrived at his numbers." [FN30]

The Second Circuit further noted that, despite the Tax Court's finding otherwise, the appraisal approach used by Drazner was "nearly identical" to the approach approved by the Tax Court in *Simmons*. The Second Circuit noted that although the *Simmons* appraisal took into account some additional statistical information, such data only renders an appraisal more persuasive. It does not distinguish a qualified appraisal from one that is unqualified.

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The court next turned to the Service's argument that the taxpayer's deduction should be denied because the appraisal summary, Form 8283, required to be filed with the taxpayer's return, was incomplete. The basis of the Service's argument was identical to what it later asserted in *Kaufman*—that the date and manner of acquisition of the donation and the cost or other basis of the property were not provided. The Second Circuit held that any deficiencies with the form were attributable to reasonable cause and that the form "substantially complied" with the regulations. [FN31]

Finally, the Second Circuit reversed the Tax Court's determination that the cash donation made by the taxpayer was not deductible. The Court of Appeals concluded that the donee's agreement to accept the gift of the easement was not a transfer of anything of value to the taxpayer, and thus did not constitute a quid pro quo for the gift of the cash. [FN32] The quid pro quo argument has lingered for a long time in the Service's arsenal, but the argument has generally not gained traction in court. The argument has been rejected several times. [FN33]

Scheidelman¶he fallout.

The Second Circuit's decision in *Scheidelman* was a welcome victory to taxpayers concerning completion of the Form 8283, the deductibility of cash donations, and most importantly the "qualified appraisal issue." However, taxpayers should not expect the IRS to change course as a result of the decision. The Service has shown little willingness to broadly apply taxpayer-friendly decisions in the conservation easement area, and it has already demonstrated that this stance will not change in light of the *Scheidelman* opinion.

In *Rothman,* TCM 2012-218, the Tax Court entered a Supplemental Memorandum and Opinion addressing the application of the Second Circuit's decision in *Scheidelman. Rothman* involved a situation in which the Tax Court had previously determined that the taxpayer's appraisal was not a qualified appraisal, based substantially on the Tax Court's decision in *Scheidelman.* [FN34] After the Second Circuit issued its *Scheidelman* decision, the taxpayer in *Rothman* moved the Tax Court to reconsider and vacate its prior decision. The Tax Court acknowledged that the Second Circuit's decision in *Scheidelman* was binding on the court under the Golsen Rule, and vacated the portion of its opinion that related to specific failures ***41** addressed in *Scheidelman.* However, the Tax Court affirmed its conclusion that the appraisal was not a qualified appraisal. The court held that the appraisal failed to meet other requirements under Reg. 1.170A-13(c)(3) that were not at issue in *Scheidelman.* In so holding, the Tax Court interpreted the Second Circuit's decision in *Scheidelman* very narrowly.

Recently, in *Gorra,* Docket No. 15366-10, a façade easement case currently before the Tax Court, the taxpayer submitted a Motion for Partial Summary Judgment on the issue of whether the appraisal he submitted was a "qualified appraisal." The taxpayer argued that his appraisal was very similar to the appraisal at issue in *Scheidelman,* and should be determined to be a qualified appraisal. The motion had not been decided at the time of this writing. However, the arguments made by the Service in its response to the motion for partial summary judgment shed light on how it is reacting to the *Scheidelman* decision. In its response, the Service asserted that *Scheidelman* was not applicable because (1) the particular facts of the appraisal at issue were different than those in *Scheidelman* and (2) a different statutory scheme was applicable in *Gorra.*

With respect to the first issue, the Service stated as follows:

> The Second Circuit in *Scheidelman* states that a qualified appraisal must include enough information to "enable ... the IRS to evaluate [the appraiser's] methodology." The [appraisal at issue] does not state the method of valuation actually used to determine the value of [the] easement and does not adequately explain how it arrived at that value. Therefore, [the appraisal] fails to meet the requirement of Treas. Reg. Sec.

1.170A-13(c)(3)(ii)(J) and (K) and is not a qualified appraisal.

The Service's distinction between the facts at issue in *Gorra* and those addressed in *Scheidelman* is arguably stretched, as the appraisers in both cases stated that they applied the before and after approach when valuing the property and described similar reasons.

With respect to the second item, the Service argued that the Pension Protection Act (PPA) of 2006, which in this instance applies to returns filed after 8/17/06, amended Section 170(f)(11)(E) by expanding the requirements for a "qualified appraisal." Specifically, the Service argued that the law now required that an appraisal must follow "generally accepted appraisal standards." While it is true that the version of Section 170(f)(11)(E) that was analyzed by the Second Circuit in *Scheidelman* did not contain the "generally accepted appraisal standards" language added by the PPA, it is difficult to understand how this distinction would alter the Second Circuit's analysis. [FN35]

Finally, it is worth noting that the petitioner in *Gorra* resided in New York, and an appeal of the case would be to the Second Circuit, the same court that decided *Scheidelman.* For this reason, the Service could not argue that *Scheidelman* was not binding precedent on the Tax Court under the Golson Rule. However, in all cases not appealable to the Second Circuit, the Service is almost certain to argue that *Scheidelman* is not applicable.

Conclusion

It is difficult to predict how the law pertaining to conservation easements will evolve over the upcoming years. Considering the number of cases now before the courts and the number of cases still in the administrative process, it is safe to assume additional guidance will be forthcoming. What appears clear is that taxpayers have substantial obstacles to overcome with respect to "foot fault" or "qualification issues." There are a host of requirements pertaining to qualifying and substantiating a conservation easement. The Service appears to be scouring easement donations to determine if any of these requirements were not met. In some instances the Service has been very creative in its interpretation of the requirements, fashioning requirements donors never anticipated.

Taxpayer results on the technical issues have been mixed in the Tax Court. In some instances the Tax Court is willing to excuse minor technical deficiencies under the "substantial compliance" doctrine and other related concepts. [FN36] For example, the Tax Court has recently stated that the "contemporaneous written acknowledgment" requirement under Section 170(f)(8) can be satisfied by language in the conservation easement deed. [FN37] Additionally, in some instances, the Tax Court has refused to adopt creative or strained arguments by the Service regarding the interpretation of the regulations pertaining to conservation easements. [FN38] As the *Scheidelman* and *Kaufman* decisions demonstrate, however, the Tax Court has issued some very unfavorable decisions to taxpayers on technical issues.

From the few decisions that have been issued by the circuit courts of appeals, it appears that these courts are finding it difficult to deny charitable deductions based on overly technical and arguably incorrect interpretations of ***42** the Code and regulations. First, the D.C. Circuit affirmed, and arguably broadened, the application of substantial compliance to conservation easement contributions. Next, the First Circuit reversed the Tax Court and rejected the Service's interpretation of the regulations applicable to subordination agreements and the "proceeds" clause, as well as the Service's application of the regulations pertaining to Form 8283. Finally, the Second Circuit reversed the Tax Court and rejected the Service's interpretation of the "qualified appraisal" requirement.

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Although the recent decisions by the courts of appeals are welcome developments for taxpayers, taxpayers should not be overly optimistic. It is unlikely the IRS will be willing to apply the decisions in any instance not mandated under the Golsen Rule. Moreover, the Service, with some support in the Tax Court, has read the decisions very narrowly, limiting their application, and perhaps requiring additional appeals. Finally, the circuit court decisions, particularly the *Kaufman* decision, indicate that, notwithstanding overly technical readings and application of the substantiation rules, valuation remains a significant issue of fact. The statements made by the Second Circuit in *Scheidelman* indicate that value should be closely scrutinized by the Tax Court, and that penalties should be carefully considered in instances in which value has been overstated.

In *Kaufman* and *Scheidelman,* the appellate courts found that the IRS and the Tax Court went too far in their narrow interpretations

On appeal, the taxpayer argued that the Tax Court had commingle two independent regulations to create a requirement that had never before existed.

Considering the Service's aggressive positions in previous easement cases, there is much pessimism that the IRS will acquiesce in the First Circuit's opinion.

The Second Circuit held that ‘the regulation requires only that the appraiser identify the valuation method used; it does not require that the method adopted be reliable.

The Second Circuit's *Scheidelman* decision was a welcome victory, but taxpayers should not expect the IRS to change course.

Taxpayers have substantial obstacles to overcome with respect to ‘foot fault’ or ‘qualification issues.’

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[FN1]. Wooldridge et al., “Simmons—Substantial Compliance Revisited, 126 Tax Notes 474 (1/25/10).

[FN2]. Kaufman (“Kaufman I”) 134 TC 182 (2010).

[FN3]. Section 170(h)(5)(A); Regs. 1.170A-14(b)(2) , (g)(1) , (g)(2) .

[FN4]. Kaufman (“Kaufman II”). 136 TC 294 (2011), 299.

[FN5]. The other issues consisted of the deductibility of the cash payment made by the taxpayer to the donee and the application of penalties.

[FN6]. Kaufman II, *supra* note 4.

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[FN7]. Kaufman v. Shulman, 687 F.3d 21, 26, 110 AFTR2d 2012-5278 (CA-1, 2012).

[FN8]. *Id.*, citing Kaufman II, *supra* note 4 at 299, 313; Kaufman I, supra note 2 at 187.

[FN9]. Kaufman v. Shulman, *supra* note 1 at 26.

[FN10]. *Id*. (citation omitted).

[FN11]. Kaufman v. Shulman, *supra* note 1 at 26.

[FN12]. Kaufman v. Shulman, *supra* note 1 at 27.

[FN13]. Kaufman v. Shulman, *supra* note 1 at 28. (emphasis in original).

[FN14]. The court noted that the Service's reading of the regulation would inappropriately deprive the donee organization of flexibility to deal with remote contingencies. If the Service was concerned about the donee organization properly exercising its rights, it has the ability under Reg. 1.501(c)(3)-1 to regulate the organizations.

[FN15]. Kaufman v. Shulman, *supra* note 1 at 29. The court reasoned that the easement was created upon donation, and was therefore not acquired.

[FN16]. Scheidelman is explored in more detail below.

[FN17]. The court here noted, as its footnote 9, "See Stipulated Order of Permanent Injunction, McClain, No. 11-1087 (DC D.C., 7/15/11), which *inter alia* prevents a trust from claiming that the IRS has recognized a 'safe harbor' for easement valuation in the 10%-15% range and from '[p]articipating in the appraisal process for a conservation easement in any regard, including but not limited to recommending ... any appraiser ... or list of appraisers' beyond furnishing a list of all appraisers who have been certified to appraise conservation easements by a profession organization."

[FN18]. The Golsen Rule was articulated in Golsen, 54 TC 742 (1970).

[FN19]. Representatives of the Service have recently stated publicly that Service does not agree with the Kaufman and Scheidelman decisions and will not acquiesce to them.

[FN20]. Drazner's percentage diminution determination was consistent with an article entitled "Façade Easement Contributions" that was prepared by Mark Primoli of the IRS, which was included as part of the Service's 1994 Market Segment Specialization Program Audit Technique Guide on the Rehabilitation Tax Credit. The article was published at one point on the National Park Service Web site, and was commonly referred to and often relied on by façade easement appraisers.

[FN21]. The IRS also asserted that the appraisal did not describe the property contributed, did not include the terms of the easement deed, and did not include a statement that it was prepared for income tax purposes.

[FN22]. The Tax Court did not ever reach a conclusion on this issue, presumably because it determined that failure to obtain a qualified appraisal was sufficient to disallow the taxpayer's deduction.

[FN23]. In prior cases, the courts had acknowledged that, in certain instances, "substantial compliance" with the contribution rules was sufficient to entitle the donor to a deduction. See, e.g., Simmons, TCM 2009-208. See also Wooldridge et al., *supra* note 1.

[FN24]. Scheidelman, TCM 2010-151 (citation and internal quotations omitted).

[FN25]. *Id.*

[FN26]. *Id.*

[FN27]. *Id.*

[FN28]. Scheidelman, 682 F.3d 189, 197, 109 AFTR2d 2012-2536 (CA-2, 2012).

[FN29]. *Id.* at 196.

[FN30]. *Id.*

[FN31]. *Id.* at 200.

[FN32]. *Id.* at 682 F.3d 200-201.

[FN33]. See, e.g., Dunlap, TCM 2012-126 (2012) (rejecting the Service's quid pro quo argument); See, e.g., Kaufman II, supra note 4 at 300. Representatives of the Service have recently publicly stated the Service will no longer challenge the deductibility of "stewardship" payments.

[FN34]. See Rothman, TCM 2012-163.

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[FN35]. Representatives of the Service have recently stated publicly that they believe the cases applying pre-PPA amendment law are generally not applicable to cases in which post-PPA law is applicable.

[FN36]. See, e.g., Simmons, 646 F.3d 6, 10, 107 AFTR2d 2011-2632 (CA-D.C., 2011), *aff'g* TCM 2009-208; and Averyt, TCM 2012-198.

[FN37]. See, e.g., R.P. Golf, LLC et al., TCM 2012-282 and Averyt, TCM 2012-198. But see Schrimsher TCM 2011-71.

[FN38]. See, e.g., Butler, TCM 2012-72 (Tax Court refuses to accept Service's overly aggressive application of conservation purpose and “inconsistent use” requirements).

24 TXNEXEMPT 35

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