No. 20-13700

United States Court of Appeals

for the

Eleventh Circuit

DAVID F. HEWITT AND TAMMY K. HEWITT,

Petitioners – Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent – Appellee.

APPEAL FROM THE UNITED STATES TAX COURT

Docket No. 23809-17;

(Hon. Joseph Robert Goeke)

APPELLANTS' MOTION FOR LEAVE TO FILE CORRECTIVE INITIAL BRIEF

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CERTIFICATE OF INTERESTED PERSONS

Pursuant to 11th Circuit R. 26.1-1, 26.1-3, and 27-1, it is hereby certified that the following persons and entities have an interest in the outcome of this case or have participated as attorneys or judges in the adjudication of this case:

Abernathy, Logan Chaney, Attorney, Petitioners-Appellants;

Anderson, Jerrika C., Attorney, Internal Revenue Service;

Cleverdon, Edwin B., Senior Attorney, Internal Revenue Service;

Crump, Horace, Associate Area Counsel, Internal Revenue Service;

Desmond, Michael J., Chief Counsel, Internal Revenue Service;

Dillard, Robert, Area Counsel, Internal Revenue Service;

Goeke, Joseph Robert, Judge, United State Tax Court;

Hewitt, David F., Petitioner-Appellant;

Hewitt, Tammy K., Petitioner-Appellant;

Jackson, Sidney W., IV, Attorney for Petitioners-Appellants;

Levin, Michelle Abroms, Attorney for Petitioners-Appellants;

Levitt, Ronald A., Attorney for Petitioners-Appellants;

McNeely, Bruce, Division Counsel, Internal Revenue Service;

Rhodes, Gregory P., Attorney for Petitioners-Appellants;

Wong, Sherra, Attorney for Appellee, Tax Division, USDOJ;

Wooldridge, David W., Attorney for Petitioners-Appellants.

APPELLANTS' MOTION FOR LEAVE TO FILE CORRECTIVE INITIAL BRIEF

Appellants respectfully move, pursuant to Eleventh Circuit Rule 27-1(c)(3), for leave to file a corrective initial brief in the proceeding, *Hewitt v. Commissioner*, Appeal No. 20-13700, now pending before this Court, in order to correct a typographical error present in Appellants' Initial Brief filed on December 10, 2020. In support of such Motion, Appellants state as follows:

Appellants' Initial Brief contains a heading on page forty-six of the Brief stating, "The Government's Interpretation of the Proceeds Regulation Renders the Statute Invalid Under *Chevron.*" This heading contains a typographical error that was discovered shortly after the Initial Brief was filed. Instead, the heading should read, "The Government's Interpretation of the Proceeds Regulation Renders the Regulation Invalid Under *Chevron.*"

To assist the Court in considering Appellants' position in this case and to help minimize any misunderstanding or confusion, Appellants respectfully request leave to file a corrected brief, which revises the heading in the table of contents and in the corrected brief's body to accurately reflect the Appellants' arguments under that

heading. For purposes of facilitating this correction, the corrected brief is attached to this Motion as Exhibit 1. No other changes have been made to the corrected brief.

The Appellee neither objects to this Motion nor the corrected brief.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

With Type-Volume Limitation, Typeface Requirements, and Type-Style Requirements

Case No. 20-13700

1. This document complies with the word limit of Fed. R. App. P. 27(d)(2)(A) because:

   [X] This document contains 265 words, excluding accompanying documents authorized by Fed. R. App. P. 27(a)(2)(B), or

   [ ] This brief uses a monospaced typeface and contains the appropriate number lines of text, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

2. This document complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6), which are incorporated by Fed. R. App. P. 27(d)(1)(E), because:

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Respectfully submitted:

s/MICHELLE ABROMS LEVIN
Michelle Abroms Levin
Attorney for Appellants

Dated: January 28, 2021

CERTIFICATE OF SERVICE

I hereby certify that on January 28, 2021 I electronically filed the foregoing document with the Clerk of the Court using the Court's CM/ECF system. I also hereby certify that the foregoing document is being served this day on all counsel of record identified on the Service List in the manner specified, via transmission of Notices of Electronic Filing generated by CM/ECF or in some other authorized manner for those counsel or parties who are no authorized to receive electronically Notices of Electronic Filing.

s/MICHELLE ABROMS LEVIN
Michelle Abroms Levin

Exhibit 1

No. 20-13700

United States Court of Appeals

for the

Eleventh Circuit

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Petitioners – Appellants,

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INITIAL BRIEF OF APPELLANTS

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McNeely, Bruce, Division Counsel, Internal Revenue Service;

Rhodes, Gregory P., Attorney for Petitioners-Appellants;

Wong, Sherra, Attorney for Appellee, Tax Division, USDOJ;

Wooldridge, David W., Attorney for Petitioners-Appellants.

STATEMENT REGARDING ORAL ARGUMENT

Mr. Hewitt donated a conservation easement to charity. That easement perpetually conserves 257 acres of prime pastureland. The Tax Court agreed the donation was worth at least $1.4 million, but denied the tax deduction Congress created for the donation. The Tax Court concluded that Mr. Hewitt's donation was deficient - not because it failed to further the conservation goals of the statute, but because it did not comply with the IRS's new and contrary interpretation of its decades-old and unexplained regulation. Under this new interpretation, Mr. Hewitt must agree at the time of donation that, in the highly unlikely event that the State of Alabama or the federal government someday condemns the property and extinguishes the easement, Mr. Hewitt's children (or any other subsequent landowner) will pay over to the land trust a portion of the judicial condemnation proceeds awarded with respect to any homes or other improvements built by Mr. Hewitt's children after the easement donation, along with all the proceeds reflecting the land trust's interest in the easement. The Internal Revenue Service ("IRS") did not previously impose such a requirement on conservation easement donors, including multiple donors whose cases have come before this Court. The Tax Court's interpretation of the conservation easement deduction rules will frustrate Congress's intent for thousands of easement donations.

In denying the charitable contribution deduction that Mr. and Mrs. Hewitt ("Hewitts") claimed for the donation, the Tax Court relied on an incorrect interpretation of Treasury Regulation §1.170A-14(g)(6) (referred to herein as the "Proceeds Regulation" or "Regulation"). The Tax Court adopted its recent opinion in *Oakbrook Land Holdings v. Commissioner*, 154 T.C. No. 10, 2020 WL 2395992 (T.C. 2020), *appeal docketed*, No. 20-2117 (6th Cir. Nov. 16, 2020) ("*Oakbrook*"). In that case, dissenting Tax Court Judge Mark Holmes and concurring Judge Emin Toro (joined by two other judges) explained at length why the Proceeds Regulation, as interpreted by the IRS, is invalid under the Administrative Procedure Act ("APA"). *Id*. at *12-45.

Judge Holmes warned that "[o]ur holding today will likely deny any charitable deduction to hundreds or thousands of taxpayers who donated conservation easements that protect perhaps millions of acres." *Id*. at *28. Judge Holmes carefully reviewed the administrative record and outlined the reasons why, under the Tax Court's ruling, "the Treasury Department gets to ignore basic principles of administrative law." *Id.*

The Tax Court's holding must be reversed because (1) Treasury failed to address significant comments concerning the Regulation at the time of its promulgation, (2) the Regulation should not be interpreted in the manner that the IRS advocated (which is inconsistent with its prior interpretations), and (3) the

requirements under the IRS's new interpretation of the Regulation are arbitrary and capricious and inconsistent with the rights that the Hewitts are permitted to retain under the statute.

Appellants request oral argument. The Tax Court's approach to this issue will deny deductions that Congress intended to grant to thousands of charitable donors, including many in this judicial circuit. Moreover, the Tax Court's refusal to enforce the APA's requirements will give the IRS free rein to create regulatory requirements without consideration of, or response to comments, or views from significant stakeholders. The Supreme Court has rejected such brazen agency action time and again, and this Court should do so here.

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STATEMENT OF JURISDICTION

This is an appeal of the June 12, 2020 decision of the United States Tax Court, which determined that Appellants were not entitled to carry-over income tax deductions in 2013 and 2014 for their charitable donation of a conservation easement in 2012. The Tax Court had jurisdiction pursuant to 26 U.S.C. §6214. This Court has jurisdiction to review decisions of the Tax Court pursuant to 26 U.S.C. §7482(a)(1). Venue for this appeal is proper in the Eleventh Circuit under 26 U.S.C. §7482(b) because Appellants resided in Randolph County, Alabama at the time the petition was filed in Tax Court.

STATEMENT OF THE ISSUES

The Tax Court relied on an incorrect interpretation of an invalid Treasury Regulation to deny the Hewitts' charitable contribution deduction for their donation of a conservation easement. Mr. Hewitt's donation of a conservation easement over a farm long held by his family is precisely the sort of charitable activity that Congress sought to encourage by creating charitable deductions for conservation easements in section 170(h) of the Internal Revenue Code ("I.R.C.", which is codified in Title 26 of the U.S. Code). Under §170(h), a landowner can claim a deduction for donating a qualified real property interest to a qualified organization, *i.e.*, a specified set of sticks in the landowner's ownership bundle.

Mr. Hewitt's donation complied with the rules set forth by Congress. A qualifying donation must be, *inter alia*, "exclusively for conservation purposes." I.R.C. §170(h)(1). A donation is exclusively for conservation purposes if "the conservation purpose is protected in perpetuity." §170(h)(5).

Treasury issued a litany of regulatory requirements concerning protection in perpetuity. One such requirement, the Proceeds Regulation, concerns the unlikely event that the protected property is condemned, resulting in the easement's extinguishment. How should the proceeds due under the Fifth Amendment's Takings Clause be allocated between the property owner and the charitable organization that holds the easement?

To address this unlikely situation, Treasury's Proceeds Regulation requires that – at the time of donation - the donor and donee agree:

> (1) if the conservation easement is extinguished by judicial proceedings, the donee's proceeds from a subsequent sale or exchange of the property are used in a manner consistent with the conservation purposes;
>
> (2) the conservation easement "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;"
>
> (3) the proportionate value of the donee's property right remains constant; and
>
> (4) following the easement's extinguishment by judicial proceedings, "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."

Treas. Reg. §1.170A-14(g)(6)(i)-(ii). There is no dispute Mr. Hewitt's donation meets the first three requirements.

When Treasury proposed the Proceeds Regulation, several commenters expressed concerns about whether the requirement that post-extinguishment proceeds be allocated according to the "proportionate value" established at the time of donation was fair, reasonable, or even practical. Administrative Record,[1] T.D.

[1] Pursuant to 11th Circuit Rule 28-5, Appellants' brief cites the record as follows: Doc. [#], p. [#], referring to the Tax Court docket number, and the page number

8069, at 373-75, 378, 427, 501, 770, 788, 859. Some commenters suggested that existing alternative tax rules could be used to protect the easement's conservation purposes in the case of an unexpected extinguishment. *Id.* at 430, 844.

In its final regulations, published on January 14, 1986, Treasury neither addressed any of those comments nor explained whether it had considered or rejected alternatives and why. *See* Income Taxes; Qualified Conservation Contributions, 51 Fed. Reg. 1496-98 (Jan. 14, 1986) (to be codified at 26 C.F.R. pt. 1); T.D. 8069, 1986-1 C.D. 8951. In fact, the preamble to the final regulations is silent on the purpose of Treasury Regulation §1.170A-14(g)(6) and why Treasury drafted it in the manner that it was drafted. *Id.*

The Proceeds Regulation's text does not distinguish between the property itself and any improvements on the property. In the years that followed, multiple stakeholders involved in conservation efforts, including land trusts, states, and even federal agencies, interpreted the Proceeds Regulation to require that donee charitable organizations of easements be entitled to their proportionate value of proceeds attributable to the property at the time of the easement grant. Proceeds attributable

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assigned to the record by this Court's ECF header because the Tax Court's system did not assign page numbers.

Appellants cite the Administrative Record for T.D. 8069 as follows: "AR" refers to the Administrative Record and page citations are those assigned by Treasury to the Administrative Record. A copy of the AR is Ex 12-J to the parties' Joint First Stipulation of Facts and spans Volumes 3-5, and Document Numbers 30-32. Relevant portions of the AR are reproduced in Appellants' Appendix.

to post-easement improvements to the property were typically excluded when determining the land trust's share of post-extinguishment proceeds. Mr. Hewitt's easement deed, drafted by the land trust, follows this standard practice.

Between 1986 and 2016, the IRS challenged dozens of conservation easement donations with proceeds provisions that operated in the same manner as the provision in Mr. Hewitt's deed. Not once did the IRS challenge such provisions. In 2016, however, four years after Mr. Hewitt's conservation easement donation, the IRS reversed course and challenged for the first time the exclusion of post-easement improvements as violating the Proceeds Regulation. *See PBBM-Rose Hill, Ltd. v. Comm'r*, No. 026096-14 (T.C. Oct. 11, 2016) (bench opinion) (United States Tax Court Docket Search). It raised the same challenge here, arguing that the land trust must be entitled to a proportionate share of all proceeds, including a proportionate share of those proceeds attributable to homes that Mr. Hewitt's children may build in the future.

The Tax Court adopted the IRS's new and contrary interpretation, resulting in a complete disallowance of the Hewitts' deduction. Under this interpretation, the donor of a conservation easement must agree that in the highly unlikely event an easement is extinguished, the donee receives a windfall. Specifically, the donee must receive not only the proportionate share of proceeds reflecting its qualified real property interest (*i.e.*, proceeds attributable to the *donee's* ownership sticks), but

also, a proportionate share of proceeds awarded for any post-donation improvements (*i.e.*, proceeds attributable to ownership sticks the landowner retains).

As a result of the Tax Court's decision, Mr. Hewitt, and thousands of other donors who also relied on generally-accepted provisions will lose their deduction in full. The questions for this Court, therefore, are as follows:

Issue 1: Did the Tax Court err in concluding that Treasury complied with the Administrative Procedure Act, 5 U.S.C. §553(a), in promulgating Treasury Regulation §1.170A-14(g)(6) when the Administrative Record produced by the Commissioner demonstrates that: (1) more than ten commenters raised issues with the proposed regulation, including the specific issue in this case of how to allocate extinguishment proceeds attributable to improvements; and (2) Treasury failed to respond to or even address any of those concerns in the basis and purpose statement accompanying the final regulation?

Issue 2: Did the Tax Court err in adopting the IRS's interpretation of Treasury Regulation §1.170A-14(g)(6) when such interpretation is contrary to the most reasonable reading of the Regulation, contrary to the IRS's prior interpretation, and contrary to the rights Congress contemplated taxpayers would retain?

Issue 3: Did the Tax Court err in concluding that Treasury Regulation §`1.170A-14(g)(6) is not arbitrary and capricious when Treasury offered no

explanation for its decision and when the Regulation requires that the donor relinquish proceeds attributable to rights he is permitted to retain under the statute?

STATEMENT OF THE CASE

Conservation easement donations have drawn the IRS's and the Tax Court's ire in recent years due to perceived valuation abuses by certain donors of such easements. But instead of addressing valuation issues on a case-by-case basis, as the law requires, the IRS has adopted "very contestable readings of what it means for an easement to be perpetual." *Oakbrook*, at *45 (Holmes, J., dissenting). This blunderbuss approach, which is no doubt designed to save the IRS the administrative hassle of litigating the fact-intensive issue of easement valuation, will deny entire deductions for conservation easement donations that Congress sought to encourage—based on a hypothetical easement extinguishment that is highly unlikely ever to happen. This approach creates vast uncertainty that Congress explicitly sought to prevent.

David Hewitt forever parted with real value in his family's farm in order to conserve that land. He neither did so to profit from the tax system nor did he have any intention of limiting the land trust's ability to protect the conservation purposes in perpetuity. Nevertheless, the IRS disallowed the Hewitts' deduction in full based on a "very contestable reading" of the Proceeds Regulation manufactured by the IRS years after Mr. Hewitt's donation.

The Proceeds Regulation should not doom Mr. Hewitt's deduction. The IRS violated the APA's fundamental principles and statutory requirements in issuing this now-critical regulation. The central issue here is whether the IRS can use the lack of explanation and clarity in its Treasury Regulation as an enforcement tool by adopting a new interpretation that contravenes the engendered reliance interests of taxpayers and land trusts. The APA's requirements exist to preclude agencies from achieving such inequitable results. The IRS should be held accountable for failing to meet those requirements.

A. Procedural History

The Hewitts have at all relevant times resided in Randolph County, Alabama. Joint First Stipulation of Facts ¶ 1 (Doc. 29, p. 2). On December 27, 2012, David Hewitt donated a conservation easement protecting 257 acres of the family farm that his father began aggregating in the 1950s. *Id.*at ¶ 29 (Doc. 29, p. 4); Tr. 39-40 (Doc. 38, p. 48-49). A significant portion of the deduction for the 2012 donation was carried over to the Hewitts' 2013 and 2014 tax returns. Joint First Stipulation of Facts ¶¶ 20-22 (Doc. 29, p. 7). The IRS selected the Hewitts' 2013 and 2014 federal income tax returns for audit. In 2017, the IRS sent a statutory notice of deficiency to the Hewitts, disallowing their deduction for the conservation easement in full and proposing accuracy related penalties. Ex. 1-J (Doc. 29, p. 10-42). The Hewitts timely filed a petition with the United States Tax Court. Petition (Doc. 1, p. 1-14).

The Hewitts' case was tried before the Honorable Judge Goeke.[2] In its pretrial memorandum, the IRS argued that the Hewitts' easement deed failed to comply with the Proceeds Regulation due to its use of the standard "improvements clause." Ex. 4-J at ¶ 15.2 (Doc. 29, p. 72). In their post-trial briefs, the Hewitts argued that the IRS's new interpretation was wrong and adopted the arguments made in *Oakbrook* concerning the regulation's validity.

On May 12, 2020, the Tax Court issued *Oakbrook*, an opinion reviewed by the full Tax Court, addressing the Proceeds Regulation's validity. Judge Holmes, the trial judge in *Oakbrook*, dissented on the basis that the Proceeds Regulation is substantively and procedurally invalid. Judge Toro wrote a concurring opinion, joined in relevant part by two other judges, concluding that the Proceeds Regulation, as now interpreted by the IRS and the Tax Court, reflects an unreasonable interpretation of the statute under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and is procedurally invalid under the APA. Judge Toro concurred, rather than dissented, because he would have disallowed the deduction on an alternative ground not present here.

[2] The Hewitts' case was consolidated for purposes of trial with another case, *Coosa Towers, LLC v. Commissioner*, No. 23810-17 (T.C. Nov. 14, 2017). Mr. Hewitt was the tax matters partner of Coosa Towers, LLC, which donated a conservation easement in 2014. The cases were tried together to secure the relevant testimony for both cases in an efficient manner. No opinion was issued in *Coosa Towers*. It is Appellants' understanding that *Coosa Towers* is settling.

One month later, the Tax Court issued the opinion in this case. *Hewitt v. Commissioner*, 119 T.C.M. (CCH) 1593 (T.C. 2020), T.C. Memo 2020-89 ("Opinion"). The Tax Court disallowed the Hewitts' deduction in full due to an "improvements clause" in the easement deed. Op. at *19. As to the Regulation's validity, the Tax Court referred to the decision issued one month earlier in *Oakbrook*. *Id.* at *15 n.6. The Hewitts appeal the Tax Court's decision to disallow the deduction in full.

The Tax Court also concluded that the Hewitts were not subject to valuation penalties: "Mr. Hewitt's testimony regarding the value of his property [is] persuasive." *Id.* at *36. Further, the Tax Court concluded that Mr. Hewitt made every effort to comply with the tax laws and made the donation in good faith. "Mr. Hewitt did not want to donate the easement on his family farm to obtain the tax benefits. He had a genuine desire to protect the land for future generations." *Id.* at *41-42.

B. Rulings Presented for Review

This appeal presents three issues for review. First, for the reasons explained in Judge Holmes's dissent and Judge Toro's concurrence in *Oakbrook*, the Proceeds Regulation is procedurally invalid under the APA. Treasury was obligated to explain and address the issues raised concerning the Proceeds Regulation in the basis and purpose statement, which "enable[s] the reviewing court to see the objections

and why the agency reacted to them as it did." *Lloyd Noland Hosp. & Clinic v. Heckler*, 762 F.2d 1561, 1566 (11th Cir. 1985). But Treasury did neither. Thus, "where the agency has failed to provide even that minimal level of analysis, its action is arbitrary and capricious and so cannot carry the force of law." *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016). As a result, the Tax Court erred in failing to invalidate the Regulation on procedural grounds.

Second, for the reasons stated in Judge Toro's concurring opinion in *Oakbrook*, the Proceeds Regulation should not be interpreted to require allocation of extinguishment proceeds attributable to post-donation improvements between the landowner and the donee organization. The better reading of the Regulation is to exclude post-donation improvements from the "donee's property rights" described in the Regulation, which is consistent with the IRS's prior private letter ruling and the longstanding practice of many conservation organizations. Allowing the IRS to change its long-standing interpretation of the Regulation to the detriment of donors will have a chilling effect on conservation easement donations, an invaluable tool in preserving our nation's natural resources. *See BC Ranch II, L.P. v. Comm'r*, 867 F.3d 547, 553-54 (5th Cir. 2017).

Third, for the reasons stated in Judge Holmes's dissent and Judge Toro's concurrence, the Proceeds Regulation, if interpreted in the manner advocated by the

IRS and the Tax Court, is substantively invalid under the framework of *Chevron* and 5 U.S.C. §706(2). *Oakbrook*, at *18-20, *43-45.

C. Facts

(1) Qualified Conservation Contribution Statutory History

In 1980, Congress enacted legislation to encourage the conservation of natural resources and wildlife. This legislation became I.R.C. §170(h). Tax Treatment Extension Act of 1980, Pub. L. No. 96-541, §6(b), 94 Stat. 3204, 3206 (1980).

> The Committee believes that the preservation of our country's natural resources and cultural heritage is important, and the committee recognizes that conservation easements now play an important role in preservation efforts.

S. Rep. No. 96-1007, at 9 (1980), *as reprinted in* 1980 U.S.C.C.A.N. 6736, 6744. In so doing, "the Committee found it appropriate to expand the types of transfers that will qualify as deductible contributions" to include "easements and other interests in real property that under state property laws have similar attributes (e.g., a restrictive covenant)." *Id.* at 9-10. Since 1980, Congress has time and again confirmed its dedication to protecting the nation's agricultural land, like the Hewitts', through its continued funding of agricultural easement purchases. *See e.g.*, H.R. Rep. No. 113-333, at 85-97 (2014) (Conf. Rep.), *as reprinted in* 2014 U.S.C.C.A.N. 12, 85-97.

When extending the charitable contribution deduction to conservation easements, Congress noted that it "expects that regulations under this section will be

classified among those regulation projects having the highest priority" so that "potential donors [will] be secure in their knowledge that a contemplated contribution will qualify for a deduction." S. Rep. No. 96-1007, at 13.

(2) Treasury's Promulgation of Regulations

On May 23, 1983, the IRS issued a notice proposing regulations to clarify the statutory rules put into effect in §170(h). Qualified Conservation Contribution, 48 Fed. Reg. 22940 (proposed May 23, 1983) (to be codified at 26 C.F.R. pt. 1). In response to this notice, Treasury received "approximately 90 comments regarding the substance of the proposed section 170A regulation." *Oakbrook*, at *30 (Holmes, J. dissenting). Of those 90 comments, 13 directly addressed the proposed regulation that became §1.170A-14(g)(6)(ii). *Oakbrook*, at *31 (Holmes, J., dissenting). "The question of how to treat donor improvements undertaken after the grant of the easement in the event the property was subsequently sold was put squarely before Treasury during the comment period." *Id.* at *25 (Toro, J., concurring). Commenters suggested that existing alternatives would preclude potential donor windfalls, such as the tax benefit rule and the proposed "so-remote-to-as-to-be" negligible rule. AR at 430, 844.

In publishing the final regulations, Treasury did not discuss <u>any</u> of the comments made with respect to §1.170A-14(g)(6)(ii), including concerns about the treatment of donor improvements. Qualified Conservation Contributions, 51 Fed.

Reg. at 1496-98 (*see* AR at 7-9). Treasury did not explain why it rejected specific suggestions, why it altered the Regulation's language, or why it made the decision to require this specific post-extinguishment allocation. In fact, Treasury did not discuss the Proceeds Regulation at all. In its final form, the Regulation reads as follows:

> (ii) Proceeds. In case of a donation made after February 13, 1986, for 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), that proportionate value of the donee's property rights shall remain constant. Accordingly, when a change in conditions give 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.

Treas. Reg. §1.170A-14(g)(6)(ii).

(3) Absence of IRS Guidance and Taxpayer Reliance

In the 30 years that followed, donors, land trusts, and many federal agencies crafted template language to allocate proceeds in the event of a judicial extinguishment as required by the Regulation. Such template language routinely set aside the value attributable to post-easement improvements when computing the proceeds allocable to the land trust, including templates published by the Environmental Protection Agency,[3] some states,[4] many individual land trusts,[5] and the Land Trust Alliance ("Alliance"). In 2005, the Alliance published the second edition of the *Conservation Easement Handbook* (the "*Handbook*"). Elizabeth Byers & Karin Marchetti Ponte, *Conservation Easement Handbook* (2d ed., 2005). The *Handbook* explains that the regulations do not address "appreciation in value due to improvements, although allocation [consistent with the model deed] . . . is certainly

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[3] Model Conservation Easement, https://www.epa.gov/sites/production/files/2015-12/documents/nps-ordinanceuments-a2e-model-land.pdf (last visited Dec. 9, 2020) (section 9.1) (relying on *Handbook's* model deed).

[4] Example of Donated Conservation Easement (Open Space), https://www.michigan.gov/documents/MDA_ConservationEasement_164018_7.pdf (last visited Dec. 9, 2020) (section 13); Deed of Preservation and Conservation Easement, https://www.in.gov/idoa/files/PRESERVATION_AND_CONSERVATION_EASEMENT_-_INDOT_411_E_Maple_Street.pdf (last visited Dec. 9, 2020) (section 23.1).

[5] Brief for Land Trust Alliance, Inc. et al. as Amici Curiae Supporting Appellant, *PBBM-Rose Hill, Ltd. v. Comm'r*, 900 F.3d 193 (5th Cir. 2018) (No. 17-60276). 2018 WL 5087506 at *7-10.

called for as a matter of basic fairness." *Id.* at 464. When allocating proceeds, the *Handbook*'s model excludes "any increase in value after the date of this grant attributable to improvements not paid for by holder" from the value of the property on the date of extinguishment. *Id.* at 463.

Consistent with this standard practice, the Easement Deed in *Palmer Ranch Holdings, Ltd. v. Commissioner*, which conveyed a conservation easement in December 2006, provides:

> The proceeds . . . from the first lawful sale, exchange, or involuntary conversion of the Property, . . . will be distributed between Grantor and Grantee in shares proportionate to the fair market value of their respective interests at the date of such extinguishment. . . Proceeds will not include any amount awarded for the Recreational Improvements, the Nature Park Facilities, . . . or other improvements permitted hereunder."

Appellant's Appendix at 131, 812 F.3d 982 (11th Cir. 2016) (No. 14-14167) (emphasis added).

In 2008, the IRS issued a private letter ruling concluding that the:

> [S]ection 1.170[sic]-14(g)(6)(ii) requirements are also met since section 14 of the Easement provides . . the portion of the proceeds of any subsequent sale or exchange . . . of the Protected Property payable to the Donee represents a percentage interest in the fair market value of the Protected Property (less an amount attributable to the value of a permissible improvement made by Grantors, if any, after the date of the contribution of the Easement).

I.R.S. Priv. Ltr. Rul. 2008-36-014, 2008 WL 4102748 (Sept. 5, 2008) (emphasis added). Since 2008, the IRS issued no contrary guidance suggesting that removal of value attributable to donor improvements is impermissible. In fact, since 2008, the IRS has challenged several other conservation easement deductions without challenging the donor improvements clause. *See, e.g.*, *BC Ranch II*, 867 F.3d 547; *Atkinson v. Comm'r*, 110 T.C.M. (CCH) 550 (T.C. 2015); *Butler v. Comm'r*, 103 T.C.M. (CCH) 1359 (T.C. 2012) (collectively, with *Palmer Ranch*, the "Uncontested Cases").

In 2016, the IRS articulated for the first time—in litigation— its position that §1.170A-14(g)(6)(ii) required an allocation of proceeds attributable to post-donation improvements to the land trust.[6] *See Rose Hill*, No. 026096-14 (bench opinion). The IRS gave no explanation for its position change. By this time, the Hewitts' conservation easement had been in place for nearly four years.

[6] Currently pending before this Court is a Tax Court case litigated after 2016 in which the IRS articulated its new position on the Proceeds Regulation. *TOT Prop. Holdings, LLC v. Comm'r*, No. 20-11050. The briefs submitted make clear that the "improvements" language at issue here was used in several hundred other deeds. Reply Brief of Appellant at 17-19, *TOT Holdings*, No. 20-11050 (11th Cir. Aug. 19, 2020) (discussing IRS enforcement shift in 2016 and the impact on thousands of easements). The taxpayer did not argue that the IRS's interpretation of the Proceeds Regulation is erroneous, but instead, that it is irrelevant because the easement deed required an allocation of proceeds pursuant to the Proceeds Regulation if the Regulation differed from the easement deed's terms. *Id.* at 11-12.

(4) David Hewitt's decision to donate a conservation easement

Mr. Hewitt grew up in Randolph County, Alabama. His father was a World War II veteran who moved to Randolph County in the 1950s. Tr. 39:17-40:2 (Doc. 38, p. 48-49). Mr. Hewitt's father made a living farming and timbering. Tr. 40 (Doc. 38, p. 49). Mr. Hewitt grew up helping his father on the farm and continued to do so into adulthood. Tr. 41-42 (Doc. 38, p. 50-51). As an adult, Mr. Hewitt made his living through farming and timbering. Tr. 43:7-11 (Doc. 38, p. 52).

In 2012, the health of Mr. Hewitt's father began to decline. Mr. Hewitt learned of conservation easements through his farming and timbering work. Tr. 51-52 (Doc. 38, p. 60-61). Mr. Hewitt decided to place a conservation easement on his father's farm to protect it for future generations Tr. 52:18-23, 58:14-15 (Doc. 38, p. 61, 67). Mr. Hewitt selected his favorite portion of the land for the conservation easement because it was the most beautiful, and Mr. Hewitt feared that without protection, it would be developed. Tr. 53:7-54:18 (Doc. 38, p. 62-63).

Through business acquaintances familiar with conservation easements, Mr. Hewitt met Dr. Keller of the Atlantic Coast Conservancy ("ACC"). Tr. 56:17-24 (Doc. 38, p. 65). Dr. Keller was impressed with Mr. Hewitt's farm and agreed it possessed significant conservation values. Tr. 57:21-58:1 (Doc. 38, p. 66-67). Mr. Hewitt reserved five homesites for his children so that they could live on the farm if they chose to do so, though ACC reserved the right to approve the homesites'

ultimate locations to ensure that such locations would not interfere with the conservation values protected by the easement. Tr. 58:11-17; 61:8-17 (Doc. 38, p. 67, 70).

Dr. Keller drafted the conservation easement deed using ACC's standard language, which the Alliance had recommended, and that a vast number of land trusts use. Tr. 175:7-11 (Doc. 38, p. 184). Mr. Hewitt intended to protect the conservation values of the property in perpetuity. Tr. 59:17-60:5 (Doc. 38, p. 68-69). He did not ask for the post-extinguishment proceeds to be distributed in a specific manner; he simply wanted to protect the conservation purposes and comply with the charitable contribution requirements. Tr. 63:24-64:7 (Doc. 38, p. 72-73). The easement deed included the following language for purposes of complying with the Proceeds Regulation:

> 15.2 *Proceeds*. This Easement constitutes a real property interest immediately vested in Conservancy. For purposes of this Subsection, the parties stipulate that the Easement shall have at the time of Extinguishment a fair market value determined by multiplying the then fair market value of the Property unencumbered by the Easement (minus any increase in value after the date of this grant attributable to improvements) by the ratio of the of the value of the Easement at the time of this grant to the value of the Property, without deduction for the value of the Easement at the time of this grant. . . For the purposes of this paragraph, the ratio of the value of the Easement to the value of the Property unencumbered by the Easement shall remain constant.

Ex. 4-J at ¶ 15 (Doc. 29, p. 72). The conservation easement was donated on December 27, 2012. *Id.* at 1 (Doc. 29, p. 54).

(5) The Hewitts' Charitable Contribution Deduction

In 2012, the Hewitts did not have sufficient income to fully utilize the tax deduction attributable to the Easement donation. They carried the deduction over into 2013, and again in 2014. Joint First Stipulation of Facts ¶¶ 20-22 (Doc. 29, p. 7). The Hewitts relied on reputable tax professionals to ensure that they complied with the Internal Revenue Code and applicable regulations. The Hewitts relied on an expert appraiser to value the conservation easement, but Mr. Hewitt himself confirmed that the value was accurate. Tr. 66:24-67:1 (Doc. 38, p. 75-76). Mr. Hewitt found the value to be so reasonable that he paid slightly more than the per acre value determined for his easement donation to purchase a small parcel adjacent to the easement property in June 2014. Tr. 69:21-70:10 (Doc. 38, p. 78-79).

STANDARD OF REVIEW

A. Standard of Review Applicable to Tax Court Decision

The Eleventh Circuit reviews "a tax court's legal conclusions and interpretations of the tax code *de novo*." *Ocmulgee Fields, Inc. v. Comm'r*, 613 F.3d 1360, 1364 (11th Cir. 2010).

The errors Appellants identified are the Tax Court's legal errors in interpreting Treasury Regulation §1.170A-14(g)(6)(ii) and are subject to *de novo* review. *See Pine Mountain Preserve LLLP v. Comm'r*, 978 F.3d 1200, 1205 n.1 (11th Cir. 2020). Whether a Treasury Regulation is valid is a legal question subject to *de novo* review. *See, e.g., Herbel v. Comm'r*, 129 F.3d 788, 790 (5th Cir. 1997).

B. Interpretation of Charitable Contribution Statutes

Generally, deductions are a matter of legislative grace that are strictly construed. However, in the case of charitable contributions, "[c]ourts have consistently reaffirmed that public policy demands a broad and flexible interpretation of statutes governing charitable contributions." *Rockefeller v. Comm'r*, 676 F.2d 35, 42 (2d Cir. 1982) (citing *Helvering v. Bliss*, 293 U.S. 144, 150-51 (1934)). The Fifth Circuit held that "the usual strict construction of intentionally adopted tax loopholes is not applicable to grants of conservation easements made pursuant to §170(h)." *BC Ranch II*, 867 F.3d at 554.

SUMMARY OF ARGUMENT

When extending the charitable contribution deduction to include donations of partial interests in real property that further conservation (*i.e.*, conservation easements), Congress intended to incentivize such donations. Over the last several years, the IRS has thwarted this intent by conjuring new technical requirements to

disallow a great number of conservation easement deductions and upset settled reasonable taxpayer reliance interests. The IRS's hyper-technical interpretation and application of §170(h), and the regulations issued thereunder, have been rejected by several Courts of Appeals, including this one. *See Pine Mountain*, 978 F.3d 1200; *Champions Retreat Golf Found., LLC v. Comm'r*, 959 F.3d 1033 (11th Cir. 2020); *BC Ranch II*, 867 F.3d 547; *Kaufman v. Shulman*, 687 F.3d 21 (1st Cir. 2012); *Comm'r v. Simmons*, 646 F.3d 6 (D.C. Cir. 2011); *Glass v. Comm'r*, 471 F.3d 698 (6th Cir. 2006).

The IRS's position here should likewise be rejected. The IRS altered its interpretation of an ambiguous and convoluted Regulation to fully disallow the Hewitts' deduction based on a single clause in their easement deed. Clauses like the one at issue here have been used in conservation easement deeds for over 30 years and are found in template conservation easement deeds issued by other federal agencies, including the EPA.

That the IRS could even assert this new interpretation 30 years after the Regulation was issued highlights the additional basis for reversal, which is Treasury's noncompliance with the APA. The Administrative Record reveals that 13 of the 90 comments received by Treasury touched on the proposed Proceeds Regulation. *See* AR at 360-71, 372-76, 377-78, 421-30, 498-502, 503-12, 574-80, 591-94, 668-69, 770-72, 777-83, 784-89, 820-26, 838-45, 858-62. Yet the preamble

to the final regulation makes no reference to those comments and contains no discussion of the issues raised concerning the proposed allocation of post-extinguishment proceeds. *See* Qualified Conservation Contributions, 51 Fed. Reg. at 1496-98. Accordingly, several Tax Court judges concluded that "the six Federal Register columns that Treasury offered fail to provide 'that minimal level of analysis' required by the APA." *Oakbrook*, at *24 (Toro, J., concurring) (quoting *Encino*, 136 S. Ct. at 2125). Judge Holmes likewise concluded:

> Treasury didn't even acknowledge the relevant comments or expressly state its disagreement with them. Instead it just ignored them. There is not even 'a minimal level of analysis' as the Supreme Court, just a couple of years ago, insisted an agency must show if it hopes to avoid its regulation's being held procedurally invalid

Id. at *38 (Holmes, J., dissenting) (quoting *Encino*, 136 S. Ct. at 2125).

Finally, the Proceeds Regulation, as now interpreted by the IRS, is arbitrary and capricious, and therefore substantively invalid. *See* 5 U.S.C. §706(2); *Chevron*, 467 U.S. at 844. "Requiring the donor to promise to turn over to the donee proceeds in excess of the fair market value of [the donee's qualified real property] interest is inconsistent with the statutory framework, and nothing in the 'statutory purposes' compels a different conclusion." *Oakbrook*, at *19 (Toro, J., concurring). Treasury cannot demonstrate that the Proceeds Regulation is the product of reasoned decision-making because Treasury offered no reason for the decision: "The majority today comes up with as good a set of arguments as possible to justify the reasonableness

of the regulatory choices that Treasury made when it was drafting this regulation. But Treasury didn't make them." *Oakbrook*, at *44 (Holmes, J., dissenting).

These errors require a reversal of the Tax Court's decision and reinstatement of the Hewitts' tax deduction.

ARGUMENT

A. The Proceeds Regulation Is Invalid Because Treasury Failed to Comply with the Procedural Requirements of the APA

The APA sets forth the applicable requirements for agency rulemaking. 5 U.S.C. §553.[7] Relevant here is the APA's requirement that:

> After notice . . . the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments . . . After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose.

§553(c). This Court has explained that the statement should clearly and fully explain the factual and legal basis for a rule, enabling a reviewing court "to see the objections and why the agency reacted to them as it did." *Lloyd Noland*, 762 F.2d at 1566 (emphasis added). A court should avoid rubber-stamping an agency action, and instead, should ensure that the agency has taken a "hard look" at relevant issues and reasonable alternatives. *Port of Jacksonville Mar. Ad Hoc Comm., Inc. v. U.S. Coast*

[7] There is no dispute that the Proceeds Regulation is a legislative rule. *Oakbrook*, at *6.

Guard, 788 F.2d 705, 708 (11th Cir. 1986); *Neighborhood TV Co., Inc. v. F.C.C.*, 742 F.2d 629, 639 (D.C. Cir. 1984); 33 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* §8414 (2d ed. 2020) (stating that "courts made clear that they expected agencies to provide exhaustive explanations for their rules in the 'concise general statements of . . . basis and purpose' required by the APA . . .[a]nd the courts then took 'hard looks' at these explanations to ensure their rationality").

Here, Treasury was required to use the basis and purpose statement to "rebut vital relevant comments." *Lloyd Noland*, 762 F.2d at 1567. As Judge Holmes explained, Treasury's response to significant comments on the Proceeds Regulation was nothing more than the "chirping of crickets." *Oakbrook*, at *33 (Holmes, J., dissenting). Such silence is a blatant violation of the APA. Judge Thapar of the Sixth Circuit recently observed: "In recent years, [the IRS] has begun to regulate an ever-expanding sphere of everyday life – from childcare to charity to healthcare and the environment. That might be okay if the IRS followed the basic rules of administrative law. But it doesn't."[8] *CIC Services, LLC v. Comm'r*, 936 F.3d 501, 507 (6th Cir. 2019) (Mem.) (Thapar, J. dissenting), *cert. granted*, 140 S. Ct. 2737 (May 4, 2020) (No. 19-930).

[8] *See also* Kristin E. Hickman, *Coloring Outside the Lines, Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727, 1748-50 (2007) (finding that even when Treasury issues notice and solicit comments, it rarely complies with the APA's requirements).

(1) The Basis and Purpose Statement Fails to Explain the Proceeds Regulation

Basis and purpose statements provide courts with a mechanism to ensure that the agency has examined "the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Encino*, 136 S. Ct at 2125 (internal quotations omitted). When an agency fails "to provide even that minimal level of analysis, its action is arbitrary and capricious and so cannot carry the force of law." *Id.*

The Tax Court erroneously held that Treasury considered and explained the relevant matter presented to it when issuing the Proceeds Regulation. *Oakbrook*, at *8. Treasury received approximately ninety comments. *Id.* at *4. Thirteen commenters directly addressed the Proceeds Regulation.[9] *Id.*; *see* AR at 120-1047.

[9] The *Oakbrook* majority said that of the thirteen commenters that addressed the Proceeds Regulation, "most devoted only a few sentences to this subject, generally at the end of a submission that emphasized other matters." *Oakbrook*, at *4. This observation is not a fair characterization of the comments, and in any event, is a tacit acknowledgment that numerous commenters did in fact comment on the Proceeds Regulation. Moreover, it was logical for commenters to organize their comments in this way. In most instances, commenters provided a general statement regarding the proposed regulations before breaking down specific problems with and suggestions for each regulatory provision in the order that Treasury listed the provisions. The Land Trust Exchange's comment is a good example. AR at 423-30. Most, if not all, of the commenters ordered their comments to mirror the order of the regulatory provisions, rather than by supposed importance, with the 14(g)(6) provisions at the end. *Id.* In any event, there is no authority requiring Treasury to respond to only the first-mentioned comments in a submission. As Judge Toro observed, "the Commissioner can hardly complain about NYLC's brevity in this case. The Commissioner's own position with respect to donor improvements is based on a

And in response, Treasury added only two pages (six columns) addressing these eight hundred pages of comments and two hundred pages of public testimony. *See* Qualified Conservation Contributions, 51 Fed. Reg. at 1496-98. Not a single word in those columns is devoted to the Proceeds Regulation. *Id.*

The preamble contains no discussion of (1) the Proceeds Regulation's purpose, (2) Treasury's goal in issuing the Proceeds Regulation, (3) the negative comments received, or (4) Treasury's responses to those comments. *Id.* Conversely, the final regulations contain an extensive discussion about negative comments received regarding the proposed methods of determining whether preserved open space meets the Code's requirements and the IRS's position with respect to those comments. *Id.* at 1497-98. The absence of Treasury's discussion of comments relating to the distribution of post-extinguishment proceeds is stark.

Judge Toro concluded that the lack of any discussion or explanation in the six Federal Register columns concerning "the donor improvements interpretation" advanced by the IRS "fail[s] to provide 'that minimum level of analysis' required by the APA.'" *Oakbrook*, at *24 (quoting *Encino*, 136 S. Ct. at 2125) (Toro, J., concurring). Further, the Proceeds Regulation is noncompliant with the APA because Treasury failed to "respond to 'significant points' and consider 'all relevant

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single sentence, and NYLC's comments on this issue were certainly longer than a sentence." *Oakbrook*, at *27 (Toro, J., concurring).

factors' raised by the public comments." *Id*. at *25 (quoting *Carlson v. Postal Regulatory Comm'n*, 938 F.3d 337, 344 (D.C. Cir. 2019) (quoting *Home Box Office, Inc. v. F.C.C.*, 567 F.2d 9, 35-36 (D.C. Cir. 1977))).

Judge Holmes likewise found that the basis and purpose statement failed to comply with the APA for multiple reasons. First "[t]he Final Rule's statement of basis and purpose shows absolutely **no mention** of the extinguishment-proceeds clause at all, much less any mention of the proportionate-share or improvements problems." *Oakbrook*, at *33 (Holmes, J., dissenting) (emphasis added). Second, the preamble contains "**no reasoned response to any of the public's comments on those provisions**." *Id*. (emphasis added). Finally, he observed, "we aren't even the first court to notice: In *Kaufman v. Shulman*, 687 F.3d 21, 26 (1st Cir. 2012), the First Circuit was forced to guess at the apparent purpose of the section 1.170A-14(g)(6)(ii), Income Tax Regs., after noting that it 'was unexplained when first promulgated.'" *Id.*

In *Lloyd Noland*, this Court held that a basis and purpose statement was inadequate because the statement failed to give any facts underlying the agency conclusion and because the statement failed to adequately discuss a scientific study's flaws. 762 F.2d at 1567. Treasury's shortcomings here are more extensive than in *Lloyd Noland* because Treasury never even mentioned the Proceeds Regulation in its basis and purpose statement, let alone any reasons or factual support for it. Thus,

there is no substantive evidence that Treasury considered or explained the relevant matter presented to it.

(2) The Comments Addressing the Proceeds Regulation Are Relevant and Significant

The comments that Treasury received about the Proceeds Regulation were significant, and Treasury was required to address them. No court has articulated a precise standard for determining whether a particular comment is significant or the precise nature of the response required. However, because Treasury did not respond at all to any of the comments on the Proceeds Regulation, no such precise standard need be articulated in this case; Treasury's response is deficient under any standard.

Some courts held that an agency should address why alternative measures were rejected in the basis and purpose statement. *See, e.g., Indep. U.S. Tankers Owners Comm. v. Dole*, 809 F.2d 847, 852 (D.C. Cir. 1987). Other courts held that an agency should avoid leaving vital questions raised by the comments unanswered, and an agency should explain why it chose one course over another. *See, e.g., United States v. Nova Scotia Food Prod. Corp.*, 568 F.2d 240, 252 (2d Cir. 1977) (holding that "[t]he agencies certainly have a good deal of discretion in expressing the basis of a rule, but the agencies do not have quite the prerogative of obscurantism reserved to legislatures[;] . . . [w]e cannot discharge our role adequately unless we hold [the agency] to a high standard of articulation") (internal quotations omitted); *Industrial Union Dep't, AFL-CIO v. Hodgson*, 499 F.2d 467, 475-76 (D.C. Cir. 1974); *Auto.*

Parts & Accessories Assoc. v. Boyd, 407 F.2d 330, 338 (D.C. Cir. 1968). Last, some courts held that comments are significant when, if adopted, they require a change in an agency regulation. *See, e.g., Home Box Office*, 567 F.2d at 35 n.58. In other words, a comment is significant if it addresses an issue and identifies why the issue is troublesome. *Oakbrook*, at *35 (Holmes, J., dissenting).

This Court has taken the second approach. "Basis and purpose statements must enable the reviewing court to see the objections and why the agency reacted to them as it did." *Lloyd Noland*, 762 F.2d at 1566. Further, the agency must show that it considered "reasonably obvious alternatives." *Id*. at 1567 (citing *Boyd*, 407 F.2d at 338). Even a single comment, if it is relevant and significant, can require an agency response. *See, e.g., Carlson*, 938 F.3d at 346 (holding that the Commission should have addressed the public comments of a single commenter, Douglas Carlson, because the comments were relevant and significant).

Seven of the thirteen commenters that addressed the Proceeds Regulation expressed concern that allocation of post-extinguishment proceeds under the proposed Proceeds Regulation was unworkable, did not reflect the reality of the donee's interest, or could result in an unfair loss to the property owner and a corresponding windfall for the donee. *See Oakbrook*, at *31-*33 (Holmes, J., dissenting).

For example, the New York Landmarks Conservancy ("NYLC") identified four problems with the proposed Proceeds Regulation:

- it would deter prospective donors from donating conservation easements due to potential inequitable allocations (AR at 373-74);
- the Regulation improperly assumed that a conservation easement represented a positive economic value to the donee in connection with post-extinguishment proceeds (*Id.*);
- there was a potential conflict with the provision and state condemnation law (*Id.* at 374-75);
- the ratio fails to take into account improvements made by the landowner after donation, and it is unexplained whether those alter the ratio. (*Id.*)

Thus, NYLC suggested the Regulation's deletion due to its potential adverse effect on donations. *Id.* at 373-74.

The Landmarks Preservation Council of Illinois explained that the Proceeds Regulation "create[s] a potential disincentive to the donation of easements" because the Proceeds Regulation could leave a building owner in a situation where the proceeds he receives from a subsequent sale are insufficient to pay the donee and third parties, such as lenders. *Id.* at 788-89.

The Land Trust Exchange's comments identified similar problems and observed that "[t]his section may result in donors and donees having to pay real estate transfer taxes." AR at 430. As an alternative, the Land Trust Exchange suggested "the tax benefit rule and the remote future event rule should make this

section unnecessary." *Id.* The Trust for Public Land raised the concern that "[w]e have serious doubts whether the provision for the allocation of the sale proceeds following extinguishment of an easement could be enforced against anyone other than the original donor of the easement, if that is what is intended." *Id.* at 844. This commenter also suggested:

> [W]e think this provision goes further than the regulations need to go. The remote future event rule of §1.170A-13(g)(2) should suffice. The possibility that a conservation gift will become obsolete, although certain to be realized in some cases, must be negligible at the time a particular gift is made in order for it to qualify under the rule.

Id. (emphasis added).

Treasury could not simply ignore these comments, which are significant under any of the approaches: "Commenters didn't just say, 'Delete the regulation, we don't like it.' They wrote in to propose other alternatives to achieve the Code's requirement that the conservation purpose of a donated easement be preserved 'in perpetuity.'" *Oakbrook*, at *36 (Holmes, J., dissenting). Even the Nature Conservancy, the Maine Coast Heritage Trust, and the Brandywine Conservancy, "thought the provision needed to be clearer." *Id.* Altogether, the comments "identified inequities with the regulation, suggested alternatives, identified potential negative effects on the willingness of donors to make donations, uncovered potential

conflicts with state law, and simply asked for more clarity." *Id.* These comments are "significant" within the meaning of APA jurisprudence.

This Court has previously concluded that an agency failed to comply with the APA when it did not respond to comments concerning a scientific study relied upon by the agency in promulgating the regulation. *Lloyd Noland,* 762 F.2d at 1566. Here, Treasury similarly erred in failing to respond to significant comments concerning a host of issues. Particularly relevant is Treasury's failure to respond to comments raising questions about how the Proceeds Regulation would impact donor improvements, an issue that is impacting hundreds, if not thousands, of deductions now targeted by the IRS. As Judge Toro observed, "the Commissioner's actions belie any claim that the comment did not raise a significant issue." *See Oakbrook*, at *27 (Toro, J., concurring).

In sum, the comments concerning the Proceeds Regulation are significant comments because each of them addresses an issue and identifies why the issue is problematic. Treasury failed to address any of the vital questions raised by the comments or explain why it chose one course over another. Such omissions fail the APA's procedural requirements.

(3) Treasury's Cursory Statement that It Considered "All Comments" Is Insufficient to Demonstrate Compliance with the APA

An agency must show a reviewing court that it considered all relevant matter by providing a basis and purpose statement showing "what major issues of policy were ventilated . . . and why the agency reacted to them as it did." *Gen. Tel. Co. of the Southwest v. United States*, 449 F.2d 846, 862 (5th Cir. 1971) (internal quotations omitted). The explanation "may vary, but should fully explain the factual and legal basis for the rule." *Lloyd Noland*, 762 F.2d at 1566 (emphasis added).

Treasury was on notice of the APA's procedural requirements prior to the Regulation's final promulgation in 1986 because both of the above cases (and multiple cases in other circuits) were decided prior to 1986. Yet, Treasury still gave no explanations. Instead, Treasury summarily stated it "consider[ed] all [] comments regarding the proposed amendments," which the *Oakbrook* majority found sufficient. *Oakbrook*, at *7.

Judge Holmes explained why such a phrase is insufficient. "The APA . . has no provision for agencies to use ritual incantations to ward off judicial review." *Id.* at *40 (Holmes, J., dissenting)(citing *Dominion Res., Inc. v. United States*, 681 F.3d 1313, 1319 (Fed. Cir. 2012)). With good reason, "because if the APA did allow comments to be disregarded with this simple magical phrase as part of a standard form, it would make commenting meaningless." *Id.*; *see Encino*, 136 S. Ct. at 2126-

27 (concluding that the Secretary of Labor's use of such phrase was insufficient to establish APA compliance). The APA is not concerned with talismanic phrases, but instead, is meant to promote substantive and thoughtful analysis in promulgating rules. *See Dep't of Homeland Security v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1909 (2020). Thus, Treasury's comment in the preamble that it considered "all comments" is insufficient to cure its procedural failures.

(4) Minor Changes to the Proposed Regulation Are Insufficient to Demonstrate Compliance with the APA

The Tax Court also erred when it found that Treasury meaningfully responded to vital relevant comments by making minor alterations to the proposed Proceeds Regulation's text before it became final. *Oakbrook*, at *7. The proposed Proceeds Regulation before notice and comment read:

> "immediately vested in the donee organization, with a fair market value that is a minimum ascertainable proportion of the fair market value to the entire property. *See* §1.170-13(h)(3)(iii). For purposes of this paragraph (g)(5)(ii), that original minimum proportionate value of the donee's property rights shall remain constant."

AR at 89 (emphasis added). The final Proceeds Regulation reads:

> "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), that proportionate value of the donee's property rights shall remain constant."

Treas. Reg. §1.170A-14(g)(6)(ii) (emphasis added). Treasury did not explain why it made these changes. Concluding that these changes responded to significant comments—in particular with respect to the allocation of proceeds from post-donation improvements—is erroneous in multiple respects.

The majority in *Oakbrook* asserts the Proceeds Regulation was "substantially revised," but this characterization is erroneous on its face. *Oakbrook*, at *7. When comparing the proposed Proceeds Regulation to the final Regulation, both provisions intend to communicate the same substantive message. The changes were made, from all appearances, to "increase editorial clarity." *Id.* at *41 (Holmes, J., dissenting). As Judge Holmes observed, "one would be hard pressed to think of any set of facts in which the changed language would change the outcome in any particular case." *Id.*

Moreover, speculating that "Treasury clearly considered the comments" because it "substantially revised the text" of the Proceeds Regulation is not the proper standard for evaluating agency action. *Oakbrook*, at *7. Without an agency statement explaining the reason for its regulatory changes and choices, the court may not speculate as to the reasons for agency action "that the agency itself has not given." *Motor Vehicle Mfr. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co*, 463 U.S. 29, 43 (1983) (internal quotations omitted); *see Encino*, 136 S. Ct. at 2127 (holding that "[w]hatever potential reasons the Department might have [for its policy

choice], the agency in fact gave almost no reasons at all;" thus, the court could not supply any reasons for the agency action that the agency failed to provide). In short, Treasury failed to explain the changes it made as required under the APA, and the Tax Court erred in supplying reasons for Treasury.

This case is akin to *Nova Scotia*, where the court held that a basis and purpose statement failed to satisfy the APA procedural requirements due to its silence about important comments even though the agency made minor changes to the proposed regulation and stated it considered all comments in the preamble. 568 F.2d at 253.[10] The Proceeds Regulation here is invalid for the same reasons.

This Court previously considered and rejected an agency's argument that it complied with its obligations under the APA to address relevant concerns by drafting a conclusion contrary to those concerns. *Lloyd Noland*, 762 F.2d at 1566. "Basis and purpose statements must enable the reviewing court to see the **objections** and why the agency reacted to them as it did." *Id.* (emphasis added). Treasury's failure

[10] The *Oakbrook* majority contends that *Nova Scotia* is inapplicable because the proposed rule's basis was a scientific decision, and Treasury's basis for the Proceeds Regulation was not a scientific decision. *Oakbrook*, at *7 n.3. However, when the Second Circuit held that the FDA failed to provide an adequate concise general statement of the basis and purpose, it did not rely on the proposed rule's scientific basis. *Nova Scotia*, 568 F.2d at 252-53 (holding that "the comment that to apply the proposed T-T-S requirements to whitefish would destroy the commercial product was neither discussed nor answered. We think that to sanction silence in the face of such vital questions would be to make the statutory requirement of a 'concise general statement' less than an adequate safeguard against arbitrary decision-making").

to identify any objections[11] to the Proceeds Regulations and failure to respond to such objections is likewise fatal the Regulation's validity.

Finally, the Tax Court's speculation that the changes were made in response to comments from the Nature Conservancy and others, is contrary to those very comments. *See Oakbrook*, at *5. The Nature Conservancy suggested that the regulation be revised so that the land trust "will also receive the benefit of any increase in value when the **donee interests** increase based on the changes in market for **such interests**." AR at 825 (emphasis added). Likewise, the Brandywine Conservancy suggested that the regulation increase proceeds allocable to the land trust when changes "have made the **easement** proportionately more valuable than the **retained interest**." *Id.* at 593.

The final Regulation, however, as now interpreted by the Tax Court, does not simply compensate the **donee** for subsequent increases in value to the **donee's** interest. Rather, it requires that the donor compensate the donee for increases in value of the **donor's** retained interest by requiring the donee to receive a portion of proceeds attributable to the donor's post-donation improvements. It is this exact

[11] In making only slight revisions, Treasury did not mention any objections to the proposed Proceeds Regulation. Therefore, the general public cannot know what concerns, if any, were rejected, including those relating to donor improvements. Only the commenters specifically raising such issues could have inferred a consideration and rejection by Treasury.

type of deviation from the commenters' suggestions that requires an explanation under the APA.

The Tax Court's decision in *Oakbrook*, at its core, means that as long as any proposed regulation is changed, even an iota, before it is finalized, all relevant comments are deemed substantively considered and explained. This holding renders a basis and purpose statement superfluous and unnecessary. The dissent in *Oakbrook* wholly rejected this notion. *Oakbrook*, at *38-39 (Holmes, J., dissenting) (citing *Dominion*, 681 F.3d at 1319; *Nova Scotia*, 568 F.2d at 253; and *Hodgson*, 499 F.2d at 476 for support that an agency needs to at least identify considerations it found persuasive). Likewise, in *Lloyd Noland*, the Court rejected an agency's conclusion when it did not explain the underlying facts. 762 F.2d at 1567. Slight revisions to a proposed regulation's text cannot rescue the regulation from the agency's noncompliance APA's requirement that the agency explain its decision.[12]

[12] The *Oakbrook* majority's reliance on *Cal-Almond, Inc. v. United States Department of Agriculture* to suggest that the basis and purpose of the Proceeds Regulation was obvious is misplaced. *See Oakbrook*, at *8. In *Cal-Almond*, the governing statute gave an exact formula. 14 F.3d 429, 443 (9th Cir. 1993). The mechanical application of that statutory formula made the basis obvious. *Id.* Here, the proportionate value of the land trust's interest is not statutorily defined. If anything, the Regulation's formula is inconsistent with the interest conveyed under §170(h).

B. Properly Interpreted, the Proceeds Regulation Does Not Require Any Allocation of Extinguishment Proceeds Attributable to Post-Donation Improvements

(1) The Better Reading of the Proceeds Regulation Excludes Post-Donation Improvements

Because Treasury gave no explanation for the Proceeds Regulation when it was issued, donors, land trusts, and the courts have been tasked with determining how to compute the "proportionate value of the perpetual conversation restriction" at the time an easement is extinguished. Treas. Reg. §1.170A-14(g)(6)(ii). This Court should interpret the Proceeds Regulation to permit donors to meet the perpetuity requirement while retaining the right to any increase in value attributable to post-donation improvements in the event of extinguishment. Such an interpretation is consistent with the IRS's longstanding treatment of improvements (until its litigation-driven about-face), with the text of the Regulation, and with the legal interests conveyed under the statute.

The Tax Court declined to adopt this interpretation. Instead, the Tax Court was compelled to "adhere to our caselaw." Op. at *19. In so doing, the Tax Court observed that "[t]he donee's property right is the right to the perpetual conservation restriction; this is the right that is immediately vested." *Id.* (emphasis added).

However, the Tax Court's caselaw provides that the proportionate value of the donee's property right applies to ***all*** proceeds, including those attributable to post-donation improvements in which the donee has no legal or financial interest. This

is inconsistent with the property rights conveyed. Simply put, the post-donation improvements are not "sticks" in the bundle of ownership sticks donated to the land trust. Requiring that the land trust be compensated for sticks it does not own is not a reasonable reading of the Regulation.

As Judge Toro observed, the topic of improvements is "wholly absent from the text of the regulation." *Oakbrook*, at *15 (Toro, J. concurring). Judge Toro explained that the key language is the requirement that the "proportionate value of the donee's property rights shall remain constant." *Id.* at *16. Judge Toro found that the language was susceptible to two different readings. *Id.* Under the first alternative, the proportionate values of the donor's and donee's partial interests must remain constant even as the fair market value of the property as a whole varies with market conditions. *Id.* at *16-17. Under this approach, that proportion is determined at the time of the easement with respect to property existing at the time of the donation, and any subsequent improvements made by the donor could be valued and accounted for separately. Under the second alternative (first advanced by the IRS in 2016), the easement deed "must provide that the proportionate value of the donee's property rights will remain constant no matter what the donor does with respect to its own partial real property interest after the easement is granted." *Id.* at *18.

Judge Toro illustrated these two alternatives with a numerical example. If the owner of a property worth $1,000,000 donated an easement worth $500,000, the

parties do not dispute that if the value of the property increases to $2,000,000, when the property is later condemned and the easement extinguished, the donee charitable organization is entitled to receive at least 50% of the $2,000,000 proceeds. The question in this case is what happens if the property is worth $4,000,000 at the time of extinguishment because of a $2,000,000 house constructed after the grant of the easement. *Id.* at *17-18. The IRS contends (and the Tax Court accepted) that the Proceeds Regulation requires the donor to provide that the donee organization will receive 50% of the value of the $2,000,000 house in addition to its 50% interest in the $2,000,000 land proceeds. *Oakbrook*, at *18. But as Judge Toro explained, there is no textual reason why the Proceeds Regulation "may be read to force the donor to promise in the deed that the donor will turn over to the donee proceeds properly attributable to the donor's own retained real property interest." *Id.* at *17.

The IRS's longstanding approach to improvements confirms that its new litigating position is unreasonable and is not being asserted to further conservation. Treasury never issued any guidance concerning the allocation of "proceeds" attributable to post-donation improvements, and the preamble to the Proceeds Regulation is completely silent on whether "proceeds" includes amounts attributable to post-donation improvements – a property interest that did not exist at the time of

donation.[13] *See* Qualified Conservation Contributions, 51 Fed. Reg. at 1496-98. Moreover, the commenters on which the IRS claims Treasury relied on to craft the Proceeds Regulation never requested proceeds from donor improvements.

Over the 30 years since the Regulation was issued, Treasury was well aware of the prevailing practice of subtracting proceeds attributable to post-easement improvements when making the Proceeds Regulation's required allocation. *See* PLR 2008-36-014; the Uncontested Cases. Several other federal agencies and important conservation stakeholders likewise routinely use improvements clauses. *See supra* footnotes 3-5.

The IRS's new litigating position is clearly an attempt to short-circuit the more pressing valuation issues that the IRS does not want to address, rather than a position advanced to ensure conservation purposes are protected in perpetuity. As

[13] In *Rose Hill*, the Fifth Circuit looked to the Merriam-Webster definition of "proceeds" to conclude that the Regulation unambiguously required an allocation of all proceeds, including those attributable to post easement improvements. 900 F.3d at 207-08. However, the second definition of proceeds in Merriam-Webster is "the net amount received . . . after deduction of any discount or charges." *Proceeds*, Merriam-Webster Dictionary, https://www.merriam-webster.com/dictionary/-proceeds (last updated Oct. 28, 2020). In reaching its conclusion, the Fifth Circuit did not have the benefit of the Regulation's Administrative Record or Judge Toro's interpretation of the Regulation. The Fifth Circuit's conclusion that the Regulation is "unambiguous" is ultimately not supported by the dictionary definition, the context in which the Regulation was promulgated, or the IRS's own prior guidance. In light of the overwhelming evidence in this case that supports an alternative, more reasonable interpretation, the Fifth Circuit's conclusion that the Regulation is unambiguous should not be adopted here.

Judge Holmes observed, "we've come to a point where we are disallowing a great many conservation-easement deductions altogether, not for exaggeration of their value or lack of conservation purpose, but because of very contestable readings of what it means for an easement to be perpetual." *Oakbrook*, at *45 (Holmes, J., dissenting). Such interpretation is neither supported by the language of the regulatory text nor does it further the statute's purpose. Accordingly, this new interpretation should be rejected.

(2) The IRS's Interpretation of the Proceeds Regulation Is Not Entitled to Deference

Interpretations of an agency rule set forth as litigating positions are not afforded deference: "we have declined to give deference to an agency counsel's interpretation of a statute where the agency itself has articulated no position on the question." *Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 212 (1988); *see Romano-Murphy v. Comm'r*, 816 F.3d 707, 715 (11th Cir. 2016). "Deference to what appears to be nothing more than an agency's convenient litigating position would be entirely inappropriate." *Bowen*, 488 U.S. at 213; *William Bros., Inc. v. Pate*, 833 F.2d 261, 265 (11th Cir. 1987) (holding that the "court is not bound to defer to the Director's view in this case. If the Secretary has a position he wishes to express, he can do it through the proper forum, i.e., the implementation of new, clarifying regulations"). Similarly, an interpretation "that results from an

unexplained departure from prior [agency] policy and practice is not a reasonable one." *Northpoint Technology, Ltd. v. F.C.C.*, 412 F.3d 145, 156 (D.C. Cir. 2005).

In *IAL Aircraft Holding, Inc. v. FAA*, this Court concluded that the FAA's "proffered interpretation of its regulation is only a litigation position and entitled to no special deference." 206 F.3d 1042, 1045-46 (11th Cir, 2000), *vacated as moot*, 216 F.3d 1304 (11th Cir. 2000). In reaching that conclusion, this Court observed, "[t]he FAA has never formally interpreted the regulation and has never issued clarifying regulations. With the exception of presenting a defense in one other court litigation, the FAA has never offered an opinion on the meaning of the regulation." *Id.* at 1046.

Here, the IRS's position is one of convenience first articulated in 2016 and reflects a significant departure from agency policy, as evidenced by the Uncontested Cases and IRS historic guidance. Proceeds that exceed the value of the land trust's real property interest in the easement are not necessary to carry on the conservation purposes protected by that legal interest. The Tax Court's interpretation of the Proceeds Regulation's text is incorrect, and given the history of the IRS's interpretation, the government's position is not entitled to deference.

C. The Government's Interpretation of the Proceeds Regulation Renders the Regulation Invalid Under *Chevron*

An additional reason exists to reject the government's interpretation of the Proceeds Regulation: a regulation that interprets §170(h) to require donors to share extinguishment proceeds attributable to post-donation improvements is invalid under *Chevron*'s approach to statutory interpretation and cannot meet the reasoned decision-making requirement in *State Farm*.

Courts follow a two-step analysis in reviewing an agency's regulatory interpretation of a statute it enforces. First, the court determines whether Congress has "directly spoken to the precise question at issue." *Chevron*, 467 U.S. at 842. If so, the inquiry ends there, and the court must give effect to Congress's expressed and unambiguous intent. *Id*. If not, the court must defer to the agency's interpretation if it is "reasonable." *Id*. at 843-44. Specifically, the court considers whether the interpretation is "arbitrary or capricious in substance, or manifestly contrary to statute." *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 53 (2011). A determination of whether an interpretation is arbitrary or capricious requires the court to analyze "whether the [agency] has reasonably explained how the permissible interpretation it chose is 'rationally related to the goals of' the statute." *Village of Barrington v. Surface Transp. Bd.*, 636 F.3d 650, 665 (D.C. Cir. 2011) (quoting *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 388 (1999)).

The record before the Tax Court demonstrates that the Proceeds Regulation, as now interpreted by the IRS and the Tax Court, is not reasonable and instead is arbitrary, capricious, and manifestly contrary to statute. Treasury failed to establish that the Proceeds Regulation was the product of reasoned decision-making and supplied no grounds upon which a court could affirm the propriety of that Regulation. As a result, the Proceeds Regulation is due to be set aside as an invalid exercise of Treasury's rule-making authority.

(1) The Proceeds Regulation Is Arbitrary and Capricious

When applying the arbitrary and capricious standard found in step two of *Chevron*, the court "must assess, among other matters, 'whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.'" *Judulang v. Holder*, 565 U.S. 42, 53 (2011) (quoting *State Farm*, 463 U.S. at 43). Put another way, the court is required to "examine[] the reasons for agency decisions – or, as the case may be, the absence of such reasons." *Id*. Agency action is the product of reasoned decision-making if the agency "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action, including a rational connection between the facts found and the choices made." *State Farm*, 463 U.S. at 43 (internal quotations omitted); *see Nat'l Mining Ass'n v. U.S. Dep't of Labor*, 812 F.3d 843, 865 (11th Cir. 2016). On the flipside, an agency action is arbitrary and capricious if:

> [T]he agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view.

State Farm, 463 U.S. at 43. In such case, the agency action will be invalidated by the Court under the APA. 5 U.S.C. §706(2).

In *Judulang*, the Supreme Court confirmed that its analysis of the reasonableness of the agency's action under *State Farm* "would be the same" under *Chevron* step two because "we ask whether an agency interpretation is arbitrary or capricious in substance." 565 U.S. at 52 n.7 (internal quotations omitted). This Court has also incorporated the *State Farm* analysis into *Chevron*, explaining that step two of *Chevron* is "functionally equivalent to [the] traditional arbitrary and capricious" standard under *State Farm*. *Nat'l Mining*, 812 F.3d at 865 n.23.[14]

[14] Alternatively, some scholars have suggested that "*State Farm* more appropriately should be seen as an additional hurdle for agencies to jump after they have cleared *Chevron* step two." Matthew A. Melone, *Light on The Mayo: Recent Developments May Diminish the Impact of Mayo Foundation on Judicial Deference to Tax Regulations*, 13 Hastings Bus. L.J. 149, 187 (2017). Regardless of whether the *State Farm* test is subsumed in *Chevron* step two or constitutes an additional hurdle, Treasury was required to articulate a satisfactory explanation for its action. The majority's suggestion that Treasury could avoid the reasoned decisionmaking requirement in *State Farm* just because the Proceeds Regulation was a "new rule" is not supported by the applicable precedent or the APA. *See Oakbrook*, at *6 n.2.

Here, where no explanation is offered, the agency's decision cannot be the product of reasoned decision-making. The reviewing court "may not supply a reasoned basis for the agency's action that the agency itself has not given." *State Farm*, 463 U.S. at 43; *SEC v. Chenery*, 332 U.S. 194, 196 (1947) (holding that "a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action"); *Dominon*, 681 F.3d at 1319 (invalidating a Treasury Regulation under *State Farm*'s arbitrary and capricious standard when the final regulation provided no rationale for the regulation and the IRS's only guidance "provided no rationale other than a general statement that the regulations are intended to implement the avoided-cost method").

The Proceeds Regulation, under the IRS's interpretation, requires that the donor agree that he, and any future owners of the underlying property, will give the land trust proceeds attributable to improvements in which the landowner retains a legal interest in the event the easement is extinguished. In imposing this requirement, Treasury made no examination of relevant data, gave no explanation for the agency's action, and provided no evidence of a rational connection between the facts found and decision made. *See* Qualified Conservation Contributions, 51

Fed. Reg. at 1496-98. In sum, Treasury offered no reason for its decision for this Court to affirm.

Finding no relevant factors or explanation in the record to support Treasury's decision, the Tax Court simply assumed that "Treasury's overarching goal was to guarantee that the donee, upon judicial extinguishment, would receive the full share of proceeds to which it was entitled." *Oakbrook*, at *10. This statement is erroneous in two respects. First, nothing in the record demonstrates this was Treasury's goal. The judicial extinguishment provisions are not discussed in the preamble. The Tax Court cannot make-up a goal when none is given. Second, even if Treasury had stated its goal was to guarantee the donee proceeds "to which it was entitled," the Regulation does not align with that goal. As now interpreted by the IRS, the Regulation requires the donee to receive proceeds to which the donee is not entitled, *i.e.*, proceeds attributable to the donor's interest in post-donation improvements. *Id.*

The Tax Court also erred in assuming that Treasury's failure to examine relevant data or explain its decision was simply "a policy decision for Treasury . . . to make." *Id.* at *10. In *Dominion*, the Federal Circuit concluded that Treasury's lack of investigation or explanation could not be chalked up to "policy choice" 681 F.3d at 1318 (holding that the Court of Federal Claims erred in concluding that Treasury's unexplained regulatory requirements were "a 'policy choice' . . . and thus permissible"). When an investigation is not made, the ultimate decision cannot be

rationally related to the facts considered. In such cases, the agency's rule is arbitrary, capricious, and must be set aside.

In sum, Treasury could have engaged in reasoned decision-making with respect to donor improvements, but it chose not to. The Tax Court concedes that "Treasury could have drafted a regulation that addressed the possibility of donor improvements," *Oakbrook*, at *10, but it failed to address those improvements in any way – either through a revision to the regulation or by explanation in the preamble. This failure, given the specific comments concerning donor improvements, means that Treasury did not consider important aspects of the problem its rule was to address. As such, the Proceeds Regulation fails the reasoned decision-making standard of *State Farm*, as well as the second step of *Chevron*, and constitutes an arbitrary, capricious, and invalid statutory interpretation.

(2) The Tax Court's Interpretation of the Proceeds Regulation Is Contrary to the Statute.

The Proceeds Regulation, as now interpreted by the IRS and the Tax Court, is also invalid because it is manifestly contrary to the statute. Judge Toro explained this deviation from the statutory scheme in his concurrence:

> Although the statute makes clear that there can be no deduction unless the conservation purposes are "protected in perpetuity," one cannot lose track of the fact that the deduction is predicated on a "qualified real property interest" being contributed to a qualified organization. Thus, the most that a qualified organization can be entitled to receive if its "qualified real property interest" is

> extinguished in the future is the full value of that interest. **Whatever the purpose of a contribution, that purpose may not be invoked to require the donor to give the donee, as a precondition to receiving a deduction . . . a right to receive compensation properly attributed to the real property interest that the Code permits the donor to retain**. A regulation interpreted to require otherwise cannot be a permissible interpretation of the statutory text before us.

Id. at *19 (Toro, J., concurring) (emphasis added).

Deviating from the statutory bounds requires a regulatory invalidation even if the statute left some ambiguity to be filled. *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015) (explaining that even under the deferential standard of *Chevron*, "agencies must operate within the bounds of reasonable interpretation"). This Court has likewise held that "an agency may not rewrite clear statutory terms to suit its own sense of how [a] statute should operate." *Redus Florida Commercial, LLC v. Coll. Station Retail Ctr., LLC*, 777 F.3d 1187, 1196 (11th Cir. 2014) (quoting *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 328 (2014)). Treasury Regulations, like other regulations, are invalid if they impose requirements beyond the statutory text. *Good Fortune Shipping SA v. Comm'r*, 897 F.3d 256, 263 (D.C. Cir. 2018) (invaliding IRS regulation where the IRS's interpretation "instead appears to rewrite §883(c)(1) to require not only valid ownership, but ownership that is not 'difficult' to track").

The operative statute here requires the donation of a "qualified real property interest," which is a restriction on the use of property. §170(h)(2)(C); *see Pine Mountain*, 978 F.3d at 1206 (explaining that a qualifying conservation easement is ''a restriction . . . on the use[s] . . . of the real property [that] burdens what would otherwise be the landowner's fee-simply enjoyment of – and absolute discretion over – the use of its property") (internal quotations omitted). The statute further requires that such interest be conveyed "exclusively for conservation purposes." §170(h)(1)(C). A qualified real property interest is exclusively for conservation purposes if "the conservation purpose is protected in perpetuity." §170(h)(5)(A).

Nothing in §170(h) suggests that a qualified organization must be compensated above the value of its qualified real property interest donated to protect conservation purposes in perpetuity. However, the Proceeds Regulation, as interpreted by the Tax Court, requires the donor to agree to give the easement holder compensation in excess of the interest conveyed to the easement holder under §170(h).

By imposing additional regulatory obligations with respect to post-donation improvements, the IRS has "rewritten the statutory terms" to obligate the donor to give property to the land trust beyond the interest conveyance that §170(h) requires. As Judge Toro noted, "a rule interpreted to require the deed to allocate to the donee not only the proceeds attributable to its own real property interest but also a share of

the proceeds attributable to the interest the Code permits the donor to retain does not 'fit' with the statutory language and is unreasonable." *Oakbrook*, at *19 (Toro, J., concurring) (quoting *Good Fortune*, 897 F.3d at 262) (internal quotations omitted).

It is not clear whether Treasury wanted conservation easement donors to agree to forgo their rights to just compensation for condemned post-donation improvements. But it is clear that Congress did not impose such a requirement, and did not leave a gap for Treasury to fill with that requirement. Rather, Congress permitted donors to reserve an interest in the underlying property, including the right to improve that property. "The contribution must involve legally enforceable restrictions on the interest in the property retained by the donor." S. Rep. No. 96-1007, at 13 (emphasis added). Nothing in the text of the statute itself or the legislative history suggests that a landowner must agree to relinquish compensation for his interest to protect conservation purposes in perpetuity. *See United States v. Cartwright*, 411 U.S. 546, 557 (1973) (invaliding a Treasury Regulation that "is manifestly inconsistent with the most elementary provisions of the" statute). Because the Proceeds Regulation is contrary to statute, it is arbitrary, capricious, and invalid.

CONCLUSION

The Hewitts donated a valuable conservation easement. The donation complied with the statutory requirements set forth by Congress for claiming a

deduction. This Court should reject the IRS's attempt to use the Proceeds Regulation to take away the deduction that Congress granted to conservationists like the Hewitts. Rather, it is the IRS's regulation that must be set-aside due to Treasury's failure to comply with the APA in promulgating that rule. Treasury's failure to explain its rule or respond to relevant comments regarding the same has enabled the IRS to assert a litigating position that is contrary to the text of both the Regulation itself and the Internal Revenue Code. As such, the Regulation is invalid.

The Hewitts respectfully request that this Court reverse the Tax Court's judgment.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the type-volume limitations set forth in Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure. This brief uses Times New Roman 14-point typeface and contains 12,951 words.

/s/MICHELLE ABROMS LEVIN
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CERTIFICATE OF SERVICE

I hereby certify that on January 28, 2021, I electronically filed the foregoing document with the Clerk of the Court using the Court's CM/ECF system. I also hereby certify that the foregoing document is being served this day on all counsel of record identified on the Service List in the manner specified, via transmission of Notices of Electronic Filing generated by CM/ECF or in some other authorized manner for those counsel or parties who are no authorized to receive electronically Notices of Electronic Filing.

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I hereby certify that on January 28, 2021, an original signed brief and 6 copies were dispatched for delivery to the Clerk's Office of the United States Court of Appeals for the Eleventh Circuit by third-party commercial carrier for overnight delivery at the following address:

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