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' REPLY 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:

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INTRODUCTION

This is a textbook case of the important role the Administrative Procedure Act ("APA") plays in safeguarding the public from poorly-formulated agency rules and illustrates why rules issued in violation of the APA cannot stand. There is no dispute that David Hewitt donated a conservation easement to protect 257-acres of his family's property, which contained significant wildlife, forest, agricultural space, and plant habitat features. Brief of the Commissioner ("IRS Br.") at 8. Mr. Hewitt's sincere desire to preserve this property in perpetuity is also undisputed. *Id.* at 7. Finally, the Tax Court's factual findings that the value claimed by Mr. Hewitt for his donation was reasonable and that penalties should not be imposed have not been challenged. *Id.* at 11 n.3. Instead, the question before the Court is whether the IRS can fully disallow a Congressionally-authorized charitable tax deduction for purported noncompliance with the IRS's new interpretation of Treasury Regulation §1.170A-14(g)(6)(ii) ("Proceeds Regulation"), when Treasury failed to address legitimate concerns about the Regulation as formulated and failed to provide any explanation concerning the proposed regulation's basis or purpose as the APA requires.

The Commissioner attempts to overcome Treasury's procedural shortcomings with respect to the Proceeds Regulation by asking this Court to reduce Treasury's obligation to review and respond to significant comments to the point that

commenting become meaningless. *See Oakbrook Land Holdings, LLC v. Comm'r*, 154 T.C. 180, 251 (T.C. 2020) (Holmes, J., dissenting). This Court should not countenance the Commissioner's request for an exemption from the APA's notice-and-comment requirements. Requiring Treasury to comply with the APA is more important now than ever, when the IRS "has begun to regulate an ever-expanding sphere of everyday life — from childcare and charity to healthcare and the environment." *CIC Services, LLC v. I.R.S.*, 936 F.3d 501, 507 (6th Cir. 2019) (Mem.) (Thapar, J. dissenting), *cert. granted*, 140 S. Ct. 2737 (May 4, 2020) (No. 19-930).

The Commissioner's attempt to justify Treasury's silence on the Proceeds Regulation based on Treasury's "policy decision" does not save the Regulation, especially when Treasury never claimed to be making a policy decision. In fact, Treasury said nothing at all. While courts have upheld an agency "decision of less than ideal clarity if the agency's path may reasonably be discerned," the map that Treasury drew leading to the Proceeds Regulation is blank, filled in only recently with counsel's *post hoc* directions. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43 (1983) (internal quotations omitted). Such decisions cannot have the force of law.

Further, the Commissioner's interpretation of the Regulation exceeds Internal Revenue Code §170(h)'s scope, which contemplates the conveyance of an interest

that does not include post-donation improvements. Imposing extra-statutory obligations when Congress declined to do so cannot be a "reasonable" statutory interpretation.

Invalidating the Regulation will advance, not hinder, the conservation objectives underlying §170(h). The IRS's arbitrary enforcement of the unexplained Regulation has significantly undermined taxpayer confidence that the IRS will grant charitable donations of conservation easements the tax treatment that Congress intended. North American Land Trust ("NALT") Br. at 3 (stating that "the Tax Court's ruling in this case, if allowed to stand, will reduce landowners' interest in the charitable donation of conservation easements and will disallow not only this taxpayer's deduction but also . . . many more such deductions for well-conceived and well-executed conservation projects"); Jessica E. Jay, *Down the Rabbit Hole with the IRS' Challenge to Perpetual Conservation Easements, Part One*, 51 Env't L. Rep. 10136, 10143 (Feb. 2021) ("The Service's focus on technical, procedural perceptions of noncompliance, . . . threatens to undermine the sustainability of easements over time.").

I. The Proceeds Regulation Is Invalid Because Treasury Failed to Comply with the APA's Procedural Requirements

The notice-and-comment procedure required by the APA "gives affected parties fair warning of potential changes in the law and an opportunity to be heard on those changes – and it affords the agency a chance to avoid errors and make a

more informed decision." *Azar v. Allina Health Serv.*, 139 S. Ct. 1804, 1816 (2019). To further these goals, the APA requires agencies to clearly and fully explain the factual and legal basis for a regulation. *Lloyd Noland Hosp. & Clinic v. Heckler*, 762 F.2d 1561, 1566 (11th Cir. 1985).

The Commissioner asks this Court to minimize Treasury's responsibility to review and respond to comments to the point that the APA's requirements become meaningless. His position contravenes established principles of administrative law. *See St. James Hosp. v. Heckler*, 760 F.2d 1460, 1470 (7th Cir. 1985); *Lloyd Noland,* at 1566-67; *Home Box Office, Inc. v. F.C.C.*, 567 F.2d 9, 35 (D.C. Cir. 1977) ("*HBO*").

A. The Hewitts properly raised Treasury's failure to respond to several significant comments.

Though Treasury failed to respond to numerous comments concerning the Proceeds Regulation, the Commissioner argues that the Hewitts cannot challenge Treasury's procedural errors save for the comment that directly addressed the proposed regulation's inequities with respect to post-donation improvements. IRS Br. at 25-26. The Commissioner neither cites any authority for this position nor can he. Treasury's failure to address the totality of the comments concerning allocation of post-extinguishment proceeds resulted in wide-spread confusion over the Regulation's purported requirements and left this Court with no record to review.

The APA's "procedural requirements are intended to assist judicial review as well as to provide fair treatment for persons affected by a rule." *HBO*, 567 F.2d at 35. A court must take a hard look at the entirety of the administrative record in deciding a regulation's validity. *See Port of Jacksonville Mar. Ad Hoc Comm., Inc. v. U.S. Coast Guard*, 788 F.2d 705, 708 (11th Cir. 1986). The comments concerning the Regulation, collectively, raise significant concerns with the Regulation's formula and whether such a regulatory requirement was appropriate or necessary. A response to these comments was required as part of the "dialogue" between Treasury and members of the public, like the Hewitts, who would be impacted by the Regulation. *See HBO*, 567 F.2d at 35. Otherwise, the "opportunity to comment is meaningless." *Id.*

The comments submitted offered viable alternatives to the Proceeds Regulation, such as case-by-case proceeds determinations between grantor and grantee or applying the remote-possibility rule. (A215, 259, 273). Commenters also suggested that an agreed allocation in an easement deed may be unenforceable against subsequent purchasers. (A273). Finally, and critical to the Hewitts' case, commenters suggested that the required allocation was impractical or unfair, especially with respect to improvements built after the donation. (A200-02). These comments were relevant to all potential conservation easement donors, including the Hewitts.

Proper consideration of these comments would have resulted in the "wisest rule." *See United States. v. Cain*, 583 F.3d 408, 420 (6th Cir. 2009); *Oakbrook*, 154 T.C. at 229 (reasoning that "if Treasury had paid closer attention to the NYLC Comment Letter, it might have course-corrected") (Toro, J., concurring). Responses to substantive issues raised by all commenters, not just the New York Landmarks Conservancy ("NYLC"), would have notified the public of Treasury's objective and would have enabled taxpayers and other stakeholders to prepare conservation easement terms that comply with Treasury's purported requirements. *See* NALT Br. at 12-13 (discussing the development of standard conservation easement deed terms to comply with §170(h) and its regulations).

Prior judicial reviews of agency rule-making confirm that this Court can and should review Treasury's failure to consider ***all*** significant comments. In *Lloyd Noland,* this Court affirmed the district court's invalidation of a regulation based on the agency's failure to sufficiently respond to two different sets of comments that were part of the 600 comments that the agency attempted to sum up in two short columns in its preamble. 762 F.2d at 1566-67. In *Hussion v. Madigan*, this Court reviewed comments identified by the tenants as objecting to the regulation's change without questioning whether those concerns were previously raised (or could have been raised) by the tenants challenging the regulation. 950 F.2d 1546, 1553 (11th Cir. 1992). In *St. James*, the Seventh Circuit reviewed all adverse comments,

holding that the "basis and purpose statement failed to respond to many significant points made by the public in opposition to the . . . [r]ule," even though the hospital challenged a regulation only on the basis that the study underlying the regulation was deficient. 760 F.2d at 1466, 1469-70 (emphasis added). Even the Tax Court majority in *Oakbrook* reviewed all 13 comments. *Oakbrook*, 154 T.C. at 186-89.

Concluding that only parties directly impacted by comments can challenge an agency's failure to consider those comments would create tremendous inefficiencies on the judicial system. If this standard is adopted, a challenge to a regulation's procedural validity by one party would not foreclose a challenge to the procedural validity of the same regulation by another party whose circumstances are reflected in different, unaddressed comments. Moreover, sequestering procedural challenges to specifically-impacted parties undermines the APA's procedural safeguards and the public policies served by those safeguards.[1] In sum, Treasury's failure to respond to the collective objections raised to the proposed Proceeds Regulation violates the APA, rendering the Regulation invalid.

[1] For example, a landowner who forgoes easement donation due to the Regulation's formula would never be in a position to challenge the inequity of that formula, leaving some unaddressed comments challenge-proof. *See* I.R.C. § 7421.

B. Comments addressing the Proceeds Regulation, including NYLC's comment, are significant.

The additional requirements that the Commissioner seeks to impose on NYLC's comment to raise it to the level of "significant" would render almost all comments "insignificant." *See* IRS Br. at 29-30. The APA does not impose any such requirements on commenters, and the Commissioner's approach undercuts the agency's responsibility to respond to objections and provide a rationale for its decision.

In this Court, 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 (citing *Auto. Parts & Accessories Ass'n v. Boyd*, 407 F.2d 330, 338 (D.C. Cir. 1968)). The agency must also "rebut vital relevant comments." *Id.* at 1567. With respect to the Proceeds Regulation, Treasury did neither.

In his dissenting opinion in *Oakbrook*, Judge Holmes described how the comments submitted are "significant" under any Circuit's precedent.

> Looking at the comments offered here – which 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 – . . . [u]nder the caselaw these comments were significant and are entitled to an agency response.

154 T.C. at 245 (Holmes, J., dissenting). Judge Toro likewise found the NYLC's comment significant, observing "the Commissioner's actions [*i.e.*, denying

deductions for noncompliance with the Regulation] belie any claim that the comment did not raise a significant issue." *Id.* at 227 (Toro, J., concurring). The adoption of standard conservation easement terms by land trusts, states, and federal agencies that the IRS now deem noncompliant with the Regulation is the direct result of Treasury's failure to address the issues raised by the NYLC and others when finalizing the Regulation. As Judge Toro observed, this is "why the APA requires agencies to provide a meaningful opportunity for comments, which means the agency's mind must be open to considering them." *Id*. (internal quotations omitted).

The Commissioner claims that the NYLC comment was not significant enough for a response because the NYLC did not (1) explain how the proposed Regulation does not further the statutory goal, (2) "cast doubt on the reasonableness of the rule," and (3) provide a rewritten version implementing the suggested recommendation. IRS Br. at 29-30. Not only are the Commissioner's assertions concerning the NYLC's comment demonstrably incorrect, but they suggest a standard that would render most comments insignificant.

First, the NYLC directly addressed how the proposed regulation undermines the statutory goal:

> The statute was enacted by Congress to encourage the protection of our significant natural and built environment through the donation of conservation restrictions and yet, the **proposed provisions would thwart the purpose of the statute by deterring prospective donors**

(A200) (emphasis added). In so doing, the NYLC cast doubt on the rule's reasonableness since it (1) deters conservation, and (2) "fails to take into account that improvement may be made . . . which should properly alter the ratio." (A201). Finally, the NYLC offered concrete suggestions that the regulation be removed or that the "formula be revised to prevent such inequities." (A202).

The Commissioner's position here on what rises to the level of "significant" is belied by Treasury's current practice in promulgating Treasury Regulations. For example, proposed Treasury Regulation § 1.274-13 received 15 comments.[2] The basis and purpose statement fronting the final regulation contains 29 columns and addresses the substance of all comments but one[3] while the regulation's subsections span only 19 columns of the Federal Register. Qualified Transportation Fringe, Transportation and Commuting Expenses under Section 274, 85 Fed. Reg. 81391 (Dec. 16, 2020) (to be codified at 26 C.F.R. pt. 1). The basis and purpose statement at issue here balks in comparison. (A173-75).

Finally, the Commissioner has confused a "significant" comment that requires a response in the basis and purpose statement with a comment that raises a "significant issue," calling into question the Regulation's reasonableness. In the

[2] https://www.regulations.gov/document/IRS-2020-0019-0001/comment.

[3] The only comment Treasury did not respond to stated, "Due to covid 19 Im [sic] unemployed at the moment." https://www.regulations.gov/comment/IRS-2020-0019-0004. There is no question that this type comment is insignificant.

cases cited by the Commissioner, the Courts concluded that the agency was reasonable in not altering the proposed regulation in response to comments. The Courts did not address whether it was reasonable to ignore comments altogether because the comments were acknowledged and addressed. In *Hussion*, the agency "summarized the positions urged by opponents and proponents before issuing its final rule." 950 F.2d at 1549. This Court held that the final regulation was not arbitrary and capricious when "the significant objections raised by the amendment's opponents are, on the record, accounted for in the Agency's action and . . . fall far short of indicating any clear error." *Id.* at 1554. In *Altera Corporation v. Commissioner*, Treasury ***acknowledged*** comments challenging the regulation's proposed change in method. 926 F.3d 1061, 1081 (9th Cir. 2019) (discussing a preamble which stated that "Treasury and the IRS do not agree with the comments that assert that taking stock-based compensation into account . . would be inconsistent with the arm's length standard"). The split Ninth Circuit disagreed over whether Treasury provided a reasoned basis for its decision, which was contrary to the information submitted in the comments. *Id.* at 1081-82.

Treasury's failure to acknowledge the NYLC's comment (as well as several others) and to explain why it declined to alter the final rule invalidates the Regulation. *See HBO*, 567 F.2d at 35 n.58. Leaving comments concerning the proposed Regulation unanswered not only violated the agency's obligation to engage

in dialogue with the public but also left this Court with no basis to review the reasonableness of Treasury's decision. *Id*. Therefore, the dual purposes served by the APA are unmet here.

C. *Lloyd Noland* governs the issues here.

The Commissioner's attempts to distinguish *Lloyd Noland* by cabining Treasury's responding obligation to only regulations that are backed by factual and empirical evidence is unavailing. IRS Br. at 31-32. The Commissioner contrasted the regulation at issue in *Lloyd Noland*, which required a change in the Medicare formula for reimbursement of medical costs, with the "non-scientific" Proceeds Regulation, even though the Proceeds Regulation also sets forth a formula on which to "reimburse" a donor and donee upon easement extinguishment. *Id*.; 762 F.2d at 1568. Thus, *Lloyd Noland* is entirely applicable.

Essentially, the Commissioner contends that as long as a regulation "is not based on empirical studies or fact finding," there is no need for Treasury to explain the basis for its rule or to respond to comments regarding the same. *See* IRS Br. at 32-33. Courts have routinely rejected this position, holding that when agencies make policy choices, the agencies must nevertheless identify the "considerations [they] found persuasive." *See, e.g.*, *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2127 (2016) (holding that an "agency may justify its policy choice by explaining why that policy 'is more consistent with statutory language' than alternative

policies") (quoting *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 175 (2007)); *Indus. Union Dep't, AFL-CIO v. Hodgson*, 499 F.2d 467, 476 (D.C. Cir. 1974).

As the Fifth Circuit explained, when an agency "is obliged to make policy judgments where no factual certainties exist . . [it] should so state and go on to identify the considerations [it] found persuasive." *Chemical Mfrs. Ass'n, v. E.P.A.* 899 F.2d 344, 359 (5th Cir. 1990) (quoting *Hodson*, 499 F.2d at 476). In fact, "[t]his requirement has been described as 'a necessary minimum' upon which courts reviewing agency actions must 'insist.'" *Id.* (quoting *Nat'l Ass'n of Regulatory Util. Comm'r v. F.C.C.*, 737 F.2d 1095, 1140 (D.C. Cir. 1984)). As to the considerations Treasury found persuasive when deciding the formula it adopted in the Proceeds Regulation, "[w]hat we hear is the chirping of crickets." *Oakbrook*, 154 T.C. at 239 (Holmes, J., dissenting). Such an omission cannot satisfy the "necessary minimum" upon which courts must insist.

D. Treasury's preamble and clarifying changes do not remedy its failure to respond to comments or explain the Regulation.

On brief, the Commissioner concedes that the Regulation's revisions were "clarifications rather than substantive changes," retreating from *Oakbrook's* majority opinion that the proposed regulation was "substantially revised." IRS Br.

at 33; *Oakbrook*, 154 T.C. at 192.[4] However, the Commissioner's suggestion that these clarifying changes, coupled with an overarching goal referenced in the preamble, "responded to" the comments, is not supported by the facts or the law. IRS Br. at 34-35.

The applicable caselaw is clear. When commenters challenge a proposed regulation (as 7 of 13 commenters did here), the agency must give reasons why one course is chosen over another. *Encino*, 136 S. Ct. at 2127; *Lloyd Noland*, 762 F.2d at 1567; *Hodgson*, 499 F.2d at 475-76; *see Hussion*, 950 F.2d at 1553 (showing that the agency explained its thought process in promulgating the final rule instead of letting the public decipher the regulation from its overall purpose).

The Commissioner's position would require the Court to conclude that the overall "regulatory goal" of "protection in perpetuity" and clarifying edits to the proposed Regulation addressed: (1) challenges to the Regulation's wording (A212, 219, 244-46, 258); (2) confusion surrounding improvements (A201); (3) the donee's role in valuing the property right (A219, 229, 236, 279); (4) whether the Regulation will create adverse conservation incentives (A200-02, 205, 253, 258); (5) whether the allocation is enforceable against subsequent landowners (A273); and (6) whether

[4] The Commissioner also does not argue that Treasury's statement in the preamble that it "considere[ed] all [] comments" is sufficient to comply with the APA, further retreating from the *Oakbrook* majority's opinion. *See* IRS Br.; *Oakbrook*, 154 T.C. at 191-92.

the Regulation is superfluous or superseded by other applicable rules (A215, 259, 273). In reality, neither the overarching regulatory goal nor the clarifying changes to the proposed regulation address these issues or show what considerations Treasury found persuasive. Thus, neither the overall regulatory purpose of "protection in perpetuity" nor the clarifying changes satisfy the APA's procedural requirements.

II. The Regulation Is Arbitrary and Capricious

"The APA directs an agency's decision be overturned if it is . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Lloyd Noland*, 762 F.2d at 1565 (citing 5 U.S.C. § 706(2)(A)). The Supreme Court in *State Farm* outlined the factors the Court should consider in evaluating an agency decision under the APA:

> The scope of review under the "arbitrary and capricious" standard is narrow and a court is not to substitute its judgment for that of the agency. Nevertheless, the agency must examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made."

463 U.S. 29 at 43 (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)) (emphasis added). When an agency fails to provide those reasons, "[t]he reviewing court should not attempt itself to make up for such deficiencies: We may not supply a reasoned basis for the agency's action that the agency itself has not given." *Id.* (citing *SEC v. Chenery Corp*, 332 U.S. 194, 196 (1947)).

The Commissioner attempts to side-step the reasoned-decisionmaking requirement in *State Farm*, suggesting the Court should look only to *Chevron* to determine the Regulation's validity. IRS Br. at 37-38. This approach is overly simplistic and inaccurate. The Supreme Court, Eleventh Circuit, and other Circuits have reiterated that *State Farm*'s reasoned-decisionmaking requirement applies to the promulgation of all agency rules, including regulations. *See, e.g.*, *Encino*, 136 S. Ct. at 2125 (holding that "[o]ne of the basic procedural requirement of administrative rulemaking is that an agency must give adequate reasons for its decisions") (citing *State Farm*); *Dominion Res., Inc., v. United States*, 681 F.3d 1313, 1319 (Fed. Cir. 2012) (concluding that Treasury's regulation "violates the *State Farm* requirements that Treasury provide a reasoned explanation for adopting a regulation"); *Lloyd Noland*, 762 F.2d at 1567 (observing that an agency must supply "a reasoned analysis" under *State Farm* in promulgating its regulation).

A. Treasury failed to comply with the reasoned-decisionmaking standard in *State Farm*.

Treasury provided no explanation for the Regulation, let alone a satisfactory one. *See* (A173-75). While the Commissioner suggests that the Court can infer the reasonable basis for the Regulation's requirements from the preamble's discussion

of the "protected-in-perpetuity" rule,[5] the preamble contains no discussion of why Treasury decided to (1) require the parties to include a post-extinguishment allocation in the donation; (2) choose this specific post-extinguishment allocation; or (3) reject the alternatives suggested, such as application of existing rules or state law. (A173-75, 202, 205, 215, 259, 273).

With no reasons for the Regulation's technical requirements in the preamble, the Commissioner presents his own bevy of reasons to support Treasury's decision, such as the preference for "an easily administrable, bright line rule"[6] and concerns about donors having "a powerful incentive to overvalue the improvements." IRS.

[5] Notably, the Commissioner fails to quote any of the preamble that supposedly "illuminates [Treasury's] rationale for that rule." *See* IRS Br. at 34.

[6] The Commissioner's suggestion that the Regulation creates an "easily administrable, bright-line rule" (*Id.* at 42) to protect land trusts is belied by the Regulation's convoluted language, which the Fifth Circuit and the Tax Court's members have found ambiguous and which the IRS previously interpreted to exclude post-easement improvements. *See PBBM Rose Hill, Ltd., v. Comm'r*, 900 F.3d 193, 205-07 (5th Cir. 2018); *Oakbrook*, 154 T.C. at 208-12 (Toro, J., concurring); *Oakbrook Land Holdings, LLC v. Comm'r*, 119 T.C.M. (CCH) 1352, *21 (T.C. 2020); I.R.S. Priv. Ltr. Rul. 2008-36-014, 2008 WL 4102748 (Sept. 5, 2008).

Given the Regulation's ambiguities, parties in a state condemnation proceeding could argue that improvements are excluded from the Regulation's allocation, consistent with the IRS's 2008 interpretation of the Regulation. A resource-strapped donee organization would face just as much difficulty having the state court interpret the "bright line" rule in the Regulation as taxpayers are facing now.

Br. at 42-43.[7] The Commissioner also proffers new reasons developed by a law professor in a to-be-published article attached to his brief. *Id.* at 43. The problem with these reasons, as Judge Holmes observed, is "they are not the ones that Treasury itself offered at the time it issued the regulation." *Oakbrook*, 154 T.C. at 257 (citing *Chenery*, 318 U.S. at 87) (Holmes, J., dissenting).

Neither counsel nor friendly members of academia can rationalize the Regulation's reasonableness *post hoc*. *State Farm*, 463 U.S. at 50. The Supreme Court recently confirmed the "important values" served by precluding such *post hoc* rationalizations: "Considering only contemporaneous explanations for agency action . . . instills confidence that the reasons given are not simply 'convenient litigating position[s].'" *Dep't of Homeland Security v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1909 (2020) (quoting *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 155 (2012)). The Supreme Court further held that reasons for an agency rule offered in briefing, but not in the document supporting the agency's decision, "can be viewed only as impermissible *post hoc* rationalizations and thus are not properly before us." *Id.*; *American Textile Mfrs. Institute Inc., v. Donovan,* 452, U.S. 490, 539

[7] Instead of helping land trusts, as now interpreted, the Regulation will "pit land trusts against owners by compelling them to make unreasonable and illogical claims against the assets of their donors." NALT Br. at 4.

(1981) (holding that the "the *post hoc* rationalizations of the agency or the parties to this litigation cannot serve as a sufficient predicate for agency action").

Without any contemporaneously articulated reasons to support the Regulation, the Commissioner cannot demonstrate that it is the product of reasoned decisionmaking.[8] Consequently, the Regulation is an arbitrary and capricious agency action that must be set aside. 5 U.S.C. § 706(2).

B. The Regulation is not a reasonable interpretation of the statute.

Because the Commissioner cannot demonstrate that the Regulation was the product of reasoned decisionmaking, he argues that he need only prove it is reasonable under *Chevron.* The Commissioner cannot avail himself of *Chevron* deference while also flouting the procedural requirements that permit federal agencies such deference. *Encino*, 136 S. Ct. at 2125.

[8] The Commissioner's suggestion that the Regulation's age demonstrates its reasonableness conflicts with his acknowledgment that the IRS did not previously interpret the Regulation in this manner. *Compare* IRS Br. at 44 to Br. at 44-45 (describing history of non-enforcement). The procedural hurdles imposed by the Anti-Injunction Act precluded any earlier challenge. *See* I.R.C. § 7421; Kristin Hickman, *Agency-Specific Precedents: Rational Ignorance or Deliberate Strategy*, 89 Tex. L. Rev. 89, 101 (Jun 12, 2011) ("[A] Treasury regulation may be on the books for years or even decades before a naturally-occurring deficiency or refund action arises to challenge its validity."). Therefore, the Regulation's age has no bearing on its reasonableness.

Regardless of whether Treasury is entitled to *Chevron* deference here, the Regulation nevertheless cannot pass muster under *Chevron* because it requires the donor to give up rights in excess of what is contemplated in §170(h).

The Code allows a deduction for a donation of a partial interest in property in certain circumstances, including a "qualified conservation contribution." §170(f)(3)(B)(iii). The partial interest that comprises a "qualified conservation contribution" is, most commonly, "a restriction (granted in perpetuity) on the use which may be made of the real property." I.R.C. §170(h)(2)(C). The Commissioner confuses the interests donated with the interests retained, claiming that the "real property" identified in the Code includes land and improvements. IRS Br. at 40. The "real property" interest is retained by the donor. It is the "restriction on use" that is donated to the charity. The interest is "a nonpossessory interest in land of another." Jon W. Bruce & James W. Ely, *Law of Easements and Licenses in Land* §1.1 (2020). As such, "the holder may not occupy and possess the realty as does an estate owner." *Id.* Conversely, the donor retains the interest in the "real property," including improvements. The Regulation, however, requires that the donee receive a portion of proceeds attributable to the retained realty following a condemnation. This interpretation is inconsistent with the statutory text allowing the donor to retain that interest.

In *Good Fortune Shipping SA v. Commissioner*, the D.C. Circuit found a Treasury Regulation invalid that improperly limited qualified taxpayers from availing themselves of a statutory exception. 897 F.3d 256 (D.C. Cir. 2018). The statute gave foreign corporations an exemption if qualified shareholders owned 50% of the shares. *Id.* at 259. However, the regulation excluded from the qualified shareholders' pool those who own "bearer shares." *Id*. The D.C. Circuit concluded that this exclusion went beyond the statute's scope by "categorically den[ying] consideration of a recognized form of ownership." *Id.* at 262. Without support for its decision, the IRS "failed adequately to justify" its rule, causing the Court to find the Regulation "unreasonable and therefore invalid." *Id.* at 266 (internal quotations omitted).

Likewise, under the Commissioner's interpretation, the Regulation imposes requirements beyond the conveyance contemplated by the statute. Specifically, the Commissioner's asserts that, under the Regulation, the donated interest must be accompanied by the imposition of an obligation on future landowners to distribute proceeds to the charity for post-donation improvements, even if they received no benefit of a charitable deduction. Consequently, the IRS has precluded hundreds, if not thousands, of donors who complied with §170(h)'s statutory requirements from receiving the deduction contemplated by that section. This categorical exclusion is not within the statute's scope.

Moreover, imposing an obligation on third parties who did not receive the charitable deduction as a prerequisite for claiming that deduction is arbitrary and capricious. Here, David Hewitt reserved his children five homesites. (A147). Under the Commissioner's interpretation, Mr. Hewitt must agree that if his children build homes, they will be obligated to turn over most of the homes' value to the charity if the easement is extinguished. Worse, if the children borrowed money to build their homes, they would be left indebted to the bank with no recourse. Presumably, the bank and other lienholders would then pursue actions against the charity. Based on the record, Treasury "entirely failed to consider" the litany of problems, wholly unrelated to conservation, resulting from the Regulation as now interpreted. *State Farm*, 463 U.S. at 43.

Notably, Treasury does not impose a similar requirement for donations of other partial interests, such as a remainder interest in a personal residence or farm. *See* Treas. Reg. §§1.170A-7(b)(3); 1.170A-7(b)(4). Likewise, regulations governing the valuation of conservation easements provide that if the donor subsequently donates the fee simple interest, the donor may take into account the full increase in value of the improvements and underlying land in computing his deduction. Treas. Reg. §1.170A-14(h)(4) (Ex. 8). Finally, the value of reserving the right to build improvements (and the value of existing improvements) are removed when valuing the conservation easement donation. Treas. Reg. §1.170A-14(h)(3)(ii). Because the

donor receives no deduction for those improvements (or the right to build those improvements), imposing a requirement that the charity receive proceeds from such improvements is not reasonable. *Id*., NALT Br. at 10. Thus, the Regulation, as now interpreted, is arbitrary and capricious.

C. The Proceeds Regulation exceeds Treasury's authority when Congress declined to impose such a requirement.

Alternatively, this Court should invalidate the Regulation as an unreasonable interpretation of §170(h) based on the legislative history, which shows that Congress considered, and declined to impose an obligation on the landowner following an easement's extinguishment. *See Hamdan v. Rumsfeld*, 548 U.S. 557, 578-79 n.10 (2006) (finding Congress's deliberate omission of wording indicative of the statute's plain meaning and considering Congress's statements to find support for a deliberate omission); *Doe v. Chao*, 540 U.S. 614, 615, 623 (2004) (rejecting a statutory interpretation which read words into the statute that the drafting history shows Congress left "for another day" because like wording was "trimmed from the final statute") .

In June 1980, the Joint Committee on Taxation posed the following question in connection with the House bill that became current § 170(h): "Should rules be provided for situations where a transferred interest in real property, for which a

deduction was allowed . . . ceases to be used in furtherance of the conservation purposes?"[9]

In a following hearing, testimony indicated that such provision was not necessary for several reasons: state law will govern compensation of the easement holder, easement holders do not allow the extinguishment of their easement without compensation, and existing tax benefit rules would operate to repay the public's investment. *Minor Tax Bills: Hearings Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means*, 96th Cong. 223, 248 (1980). Only one individual suggested that Treasury should develop rules for easements that cease to serve their purpose. *Id.* at 245.

Neither the final law nor the accompanying Senate Report imposed a rule addressing extinguishment proceeds, and Congress did not directly or implicitly direct Treasury to do so. *See Tax Treatment Extension Act of 1980*, Pub. L. No. 96-541, 94 Stat. 3204; S. Rep. No. 96-1007, at 13 (1980), *as reprinted in* 1980 U.S.C.C.A.N. 6736, 6748 (encouraging Treasury to draft regulations concerning whether "the contemplated contribution will be considered to have been made for a qualifying conservation purpose"). Creating regulations addressing issues that

[9] Staff of J. Comm. on Taxation, 96th Cong., Description of Miscellaneous Tax Bills Scheduled for a Hearing Before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means on June 26, 1980 27 (Comm. Print 1980).

Congress declined to address, with no explicit or implicit authority from Congress, is an impermissible interpretation of the statute.

III. The Hewitts' Interpretation Is the Correct Interpretation of the Proceeds Regulation

The IRS denied the Hewitts' deduction in full after determining that a standard clause[10] in the Hewitts' conservation easement deed violated the Proceeds Regulation. In 2012, when the Hewitts donated their conservation easement, the IRS had never challenged the standard clause. Though the Tax Court and the Fifth Circuit have since concluded that the Proceeds Regulation entitles a donee to a proportionate share of proceeds attributable to post-donation improvements,[11] this interpretation yields both inequitable and absurd results and does not enhance conservation.

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[10] "[T]he Improvements Clause has been established as the national standard for tax-deductible conservation easements for over 30 years." NALT Br. at 14. The Commissioner's suggestion that the IRS is not at "fault" for the pervasive use of Improvements Clauses, including in template easement deeds made publicly available by federal agencies, is contradicted by the IRS blessing such language in a private letter ruling in 2008. I.R.S. PLR 2008-36-014. It strains credulity that the IRS was unaware of provisions recommended by the leading authoritative sources on conservation easement deed drafting, such as the *Conservation Easement Handbook*.

[11] The Tax Court's consistent "interpretation" did not begin until 2020 – over eight years after the Hewitts donated their easement. *See* IRS Br. at 19.

The inequitable results of the Commissioner's interpretation are discussed above, in the Hewitts' opening brief, and in the comments submitted by the NYLC and others. But the absurd results of interpreting the Regulation to mean that a charity has an "interest" in post-donation improvements include: (1) joint liability by the charity and landowner for any unpaid obligations secured by those improvements, such as mortgage debts, real property taxes, or tax or other liens filed against the improvements' builder; (2) transfer taxes owed by the charity if the post-donation home is sold while the easement is in place; and (3) the charity's legal obligations to maintain improvements on property owned by a third-party if the easement is extinguished prior to the property being sold. [12]

For example, in *Palmer Ranch Holdings, Ltd. v. Commissioner*, the easement donor reserved the right to build recreational buildings, including a 12,000 square-foot building, swimming pools, and basketball and tennis courts.[13] Appellant's

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[12] *See* Nancy Ortmeyer Kuhn, *The Eleventh Circuit Court of Appeals: The Current Focus for Conservation Easements*, Bloomberg Tax (Apr. 1, 2021) (discussing various unreasonable outcomes of the Regulation as now interpreted).

[13] The easement deed in *Palmer Ranch* excluded the proceeds attributable to post-donation improvements from those to be apportioned between the landowner and charity similar to the Hewitts' easement deed. Palmer-Appendix at 131. The IRS did not challenge this exclusion. While the Commissioner claims the IRS may choose "alternative bases for denying conservation easement deductions" (IRS Br. at 46), the IRS raised **no basis** for denying the deduction in *Palmer Ranch*, challenging only the value. Though the IRS may not raise ***every*** basis for disallowing a deduction, it is curious that the IRS would not substantively challenge a $25 million conservation easement donation that violates what the Commissioner

Appendix at 124, 812 F.3d 982 (11th Cir. 2016) (No. 14-14167) ("Palmer-Appendix"). If the reserved improvements were built and the easement judicially extinguished, the landowner could require that the charity, which would have the majority interest in those improvements, pay the costs of maintaining those facilities until the property sells. Alternatively, the landowner may simply forgo upkeep of improvements in which the charity has a majority interest. The result could be a net loss to the charity if the improvements fall into disrepair.

The practical impact of the Commissioner's new interpretation is not that the charities will suddenly receive increased protection in their interest, as the Commissioner insists in his brief, but that the improvements' locations will be carved out. *See, e.g., BC Ranch II, L.P. v. Comm'r*, 867 F.3d 547, 550 (5th Cir. 2017) (showing reserved homesites excluded from the conservation area). Or the improvements will be built before the easement's donation. *See, e.g., Glass v. Comm'r*, 471 F.3d 698, 700 (6th Cir. 2006) (conservation easement donated on property with taxpayer's residence already built). Such a practice undermines conservation because the land trust loses the ability to oversee the construction of improvements.[14]

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now claims is a reasonable and clear bright-line rule concerning allocation of post-extinguishment proceeds.

[14] Brief for Land Trust Alliance, Inc. et al. as Amici Curiae Supporting Appellant, *Rose Hill*, 900 F.3d 193 (No. 17-60276), 2018 WL 5087506 at *11-*14.

Finally, the Hewitts' interpretation is the most consistent with the Regulation's plain language. No words need to be added to adopt the Hewitts' interpretation.[15] The Regulation describes an interest "immediately vested" in the donee at the time of donation, which is "the proportionate value of the conservation restriction." Treas. Reg. § 1.170A-14(g)(6). Following extinguishment, the proceeds to the charity must be "at least equal to the proportionate value of the perpetual conservation restriction." *Id.* The "proportionate value" interest conveyed to the charity necessarily excludes post-donation improvements because such improvements did not exist at the time the charity's interest vested. Moreover, as the Commissioner concedes, the word "proceeds" can be read to allow for certain deductions, such as banking fees or court costs. IRS Br. at 17. But the Commissioner's arbitrary line between court costs and improvements has no support in the Regulation's actual language. Instead, the Regulation can and should be interpreted to describe the interest granted to the charity at the time of donation, which remains constant and does not include improvements created following the donation.

[15] *See* NALT Br. at 7-14.

CONCLUSION

The Commissioner's *post hoc* rationalizations and efforts to minimize Treasury's responsibilities under the APA are insufficient to save the Regulation. Treasury did not engage in the minimal level of analysis required by the APA; thus, the Regulation is invalid. Accordingly, the Tax Court's decision disallowing the Hewitts' deduction should be reversed and the case remanded to determine the donation's value.

Respectfully submitted,

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I hereby certify that on April 22, 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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