No. 20-2117

United States Court of Appeals

for the

Sixth Circuit

OAKBROOK LAND HOLDINGS, LLC, WILLIAM DUANE HORTON, TAX MATTERS PARTNER,

Petitioner/Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent/Appellee.

APPEAL FROM THE UNITED STATES TAX COURT

Docket No. 5444-13

(Hon. Mark V. Holmes)

REPLY BRIEF OF APPELLANT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Federal Statutes

Regulatory Materials

Other Authorities

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INTRODUCTION

Congress enacted I.R.C. § 170(h) to incentivize conservation of our nation's resources. This provision "was adopted (1) at the behest of conservation activists, not property-owning, potential-donor taxpayers (2) by an overwhelming majority of Congress (3) in the hope of adding untold thousands of acres of primarily rural property for various conservation purposes." *BC Ranch II, L.P. v. Comm'r*, 867 F.3d 547, 553-54 (5th Cir. 2017). And it worked; "[t]he number of acres conserved under easement is up from nearly 16,800,000 in 2015, 13,200,000 in 2010, and 6,100,000 in 2005." Mem. Op. at *12.[1] I.R.C. §170(h)'s success has provided "environment and public health benefits" and "social benefit to local, grassroots conservation

[1] *Oakbrook Land Holdings, LLC v. Comm'r*, 119 T.C.M. (CCH) 1352 (2020) ("Mem. Op.").

efforts." Southeast Regional Land Conservancy ("SRLC") Br. 11. In 2015, several years after Oakbrook's donation, Congress reiterated its support for charitable donations of partial interests in property under §170(h). "The Committee believes that the special rule that provides an increased incentive to make charitable contributions of partial interests in real property for conservation purposes is an important way of encouraging conservation and preservation." H.R. Rep. No. 114-17, at 7 (2015). *See also* National Taxpayer Union Br. 4-5 (describing the bipartisan support for an enhanced deduction in 2015). Duane Horton, Oakbrook's manager, is one of the taxpayers incentivized by §170(h) to further conservation. Amid several development projects around Chattanooga, he convinced Oakbrook's members to protect Oakbrook's property from development, perpetually preserving White Oak Mountain's ridgeline. (JA363-65).

Congress anticipated such conservation would come at a cost,[2] but the Commissioner is refusing to pay. Instead, the Commissioner is asking this Court to disallow Oakbrook's deduction altogether, as well as deductions claimed by "hundreds or thousands of taxpayers who donated the conservation easements that protect perhaps millions of acres,"[3] based on hypothetical increases and decreases in

[2] *See, e.g.*, HR Rep. No. 114-17, at 9 (estimating that making the expanded deduction under §170(h) permanent would cost $1.2 billion over the 2015-2025 period).

[3] *Oakbrook Land Holdings, LLC v. Comm'r*, 154 T.C. 180, 230 (2020) (Holmes, J., dissenting).

land value, hypothetical increases and decreases in the value of the easement restrictions; and the hypothetical value of hypothetical improvements in the case of a hypothetical extinguishment - without any evidence that these hypotheticals would ever occur.[4] The Commissioner is not trying to further the statute's conservation goals, but to deny deductions to taxpayers who did what Congress intended. "[T]he Tax Court's emphasis on hyper-technical issues is not for the benefit of land trusts. . . . The Tax Court's holding will only serve to harm land trusts and require them to incur additional costs in trying to keep their forms up to date." SRLC Br. 15.

To achieve his goal, the Commissioner wields a novel interpretation of Treasury Regulation §1.170A-14(g)(6) (the "Proceeds Regulation" or "Regulation") to "attack a clause commonly found in easements." Mem. Op. at *1. But, this battle over a hypothetical chain of unlikely events could have been and would have been avoided had Treasury complied with its obligations under the Administrative Procedure Act ("APA") to (1) examine the relevant facts and data, (2) engage in reasoned decisionmaking, and (3) explain its rule's basis and purpose in implementing a post-extinguishment allocation requirement. The APA's requirements protect regulated parties, like Oakbrook, and thousands in Oakbrook's position, from this type of "gotcha" enforcement. Because the final Regulation does

[4] The Commissioner neither presented evidence nor took the position that Oakbrook's easement is likely to be extinguished in the foreseeable future.

not comply with the APA, any purported failure to comply with the Regulation does not "doom Oakbrook's deduction." Mem. Op. at *15. Accordingly, the Tax Court's decision that the Regulation is valid is due to be reversed and Oakbrook's deduction reinstated.

I. Oakbrook's Conservation Easement Complies with § 170(h)

Having litigated the case in the Tax Court on the theory that Oakbrook did not comply with the Regulation, the Commissioner argues for the first time in his response brief that the perpetuity requirement in §170(h) imposes obligations on taxpayers beyond the ones in the Regulation. The Commissioner was wrong below, and he is wrong with his new (too-late) statutory argument here. The Regulation itself is invalid, as Oakbrook explained in its opening brief, and the statute's perpetuity requirements themselves impose no requirements about allocation of extinguishment proceeds.

There is neither support in the legislative history for the Commissioner's position nor have courts interpreted the statute in this manner. *See, e.g., McLennan v. United States*, 24 Cl. Ct. 102, 104, 107 (1991) (holding that a conservation easement donation "served an exclusive conservation purpose" based on rights conveyed even though the deed provided "[a]ny compensation for a taking action is payable exclusively to plaintiff") Moreover, if the statute requires that the donee be compensated for the "fair market value of its 'interest[] in real property' [at] the time

of the conversion of its interest into cash" (Brief of the Commissioner ("IRS Br.") at 35), then the Commissioner's own regulatory formula violates §170(h). Specifically, while the Commissioner challenges Oakbrook's deed for fixing compensation based on the easement's value on the donation date, the Regulation (as interpreted by the Commissioner) likewise fixes the donee's compensation based on the relative values of the donor's and donee's interests on the donation date (*i.e.*, the "proportionate value"). The Commissioner's purported concern about potential increases in the property's overall value ignores the Regulation's failure to account for increases in the easement's *relative* value. If the easement's relative value increased, compensation to the donee based on "the proportionate value of the perpetual conservation restriction," at the time of donation would comply with the Regulation, but would fail the new standard that the Commissioner claims §170(h) requires.[5]

[5] For example, an easement over agricultural land would not significantly reduce the land's value. At the time of donation, this easement is worth $500,000, and the land unencumbered by the easement is worth $1,000,000, creating a "date-of-grant proportionate value" of 50%. IRS Br. 43. If the land was subsequently rezoned for commercial use, the encumbered value would remain $500,000, but the unencumbered value increases to $5,000,000. This increases the easement's fair market value to $4.5 million ($5 million - $500,000) and the "proportionate value" to 90% ($4.5 million/$5 million). The Regulation allocates only 50% to the donee upon condemnation, or $2.5 million. The Commissioner's new statutory position, however, requires that the donee receive $4,500,000, the fair market value of its interest.

A. "Perpetuity" under I.R.C. §170(h) does not extend to events outside the donor's control.

The Commissioner stretches the term "perpetuity" in §170(h) beyond reason, insisting that, in addition to donating perpetually enforceable restrictions, the donor must also determine, at the time of donation, what the donee's interest will be worth in a hypothetical future condemnation.[6] This second, newly-articulated requirement is beyond what Congress envisioned. Rather, the perpetual protection of conservation purposes is effectuated through the rights given to the donee. "'Perpetuity' – as used in connection with conservation easements – draws on the term's common-law meaning and denotes only that the granted property won't automatically revert to the grantor, his heirs, or assigns.'" *Pine Mountain Preserve, LLLP v. Comm'r*, 978 F.3d 1200, 1209 (11th Cir. 2020). "Perpetuity" does not impose obligations on the donor to predict and compensate the donee for hypothetical events outside of the donor's control. As this Court recently held:

> To satisfy the "perpetuity" requirement, the donation must be "[e]nforceable in perpetuity," meaning that it includes "legally enforceable restrictions" that will prevent the

[6] Courts of Appeals have consistently rejected highly-technical IRS positions that would doom all conservation easement deductions. *See Pine Mountain*, 978 F.3d at 1209 (rejecting IRS's position that amendment clauses violated perpetuity: "If the possibility of amendment were a deal-killer, then there could be no such thing as a tax-deductible conservation easement"); *BC Ranch II*, 867 F.3d at 553 (rejecting IRS's interpretation in favor of "common-sense reasoning" adopted by First and D.C. Circuits); *Kaufman v. Shulman*, 687 F.3d 21, 27 (1st Cir. 2012) (rejecting the IRS's interpretation that "would appear to doom practically all donations of easements, which is surely contrary to the purposes of Congress").

> donor from using its retained interest in the property in a way "inconsistent with the [donation's] conservation purposes."

Hoffman Props. II, L.P. v. Comm'r, 956 F.3d 832, 834 (6th Cir. 2020) (quoting Treas. Reg. § 1.170A-14(g)(1)). This definition matches Congress's explanation for § 170(h):

> By requiring that the conservation purpose be protected in perpetuity, the Committee intends that the perpetual restrictions must be enforceable by the donee organization (and successors in interest) against all other parties in interest (including successors in interest).

S. Rep. No. 96-1007, at 14 (1980), *as reprinted in* 1980 U.S.C.C.A.N. 6736, 6749; *see also Glass v. Comm'r*, 471 F.3d 698, 713 (6th Cir. 2006) (holding that "I.R.C. §170(h)(5) . . requir[es] a donee . . . to hold the qualified real property interest in perpetuity exclusively for one or more conservation purposes") (internal quotations omitted). In sum, the perpetuity requirement centers on the restrictions and enforcement rights the donor gives the donee. No court has interpreted §170(h) to extend perpetuity to events outside the donor's control that may impact those restrictions.[7] Here, the donor donated perpetual and enforceable restrictions to

[7] In *Belk v. Commissioner*, the Commissioner argued, and the Fourth Circuit agreed, that perpetuity under §170(h) ***precludes*** the donor from substituting the land subject to the easement. 774 F.3d 221, 226-27 (4th Cir. 2014). Now, the Commissioner argues that perpetuity under §170(h) ***requires*** the substitution of money for conservation purposes in a condemnation. If a court extinguishes an easement's restrictions, money cannot recreate the conservation purposes protected by those

SRLC, which were not challenged in Tax Court. (JA44-49). Accordingly, the rights donated by Oakbrook meet the perpetuity requirement enacted by Congress.

B. The legislative history does not support the Commissioner's new statutory position.

The Commissioner's statutory position is also inconsistent with 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, 578-80 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, 622-23 (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 §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?"[8]

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restrictions. The Commissioner's new and contrary requirement is not supported by the statute's language or the common law meaning of "perpetuity."

[8] 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).

Subsequent testimony before Congress indicated that such a rule was unnecessary for several reasons: state law will govern compensation of the easement holder, easement holders do not allow the extinguishment of their easements 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).

In final form, §170(h) neither included rules addressing the easement's extinguishment nor did the accompanying Senate Report indicate that the statute contemplated such a rule. Reading this requirement into the statute now is inconsistent with Congress's decision not to impose such a requirement.

C. The Commissioner's statutory argument is untimely.

Finally, the Court should reject the Commissioner's claim that Oakbrook's proceeds clause violates requirements of §170(h) not contained in the Regulation for the same reason that Oakbrook did not address it in its opening brief: This position was neither raised before the Tax Court[9] nor did the majority adopt it as a basis for disallowing Oakbrook's deduction. As such, it is not a proper ground to be raised in a responsive brief in this appeal.

[9] *See* JA34 (arguing "the extinguishment proceeds clause . . . violates Treas. Reg. §1.170A-14(g)(6)(ii)"); JA46.

It is well settled that "appellate courts ordinarily abstain from entertaining issues that have not been raised and preserved in the court of first instance." *Wood v. Milyard*, 566 U.S. 463, 473 (2012). An appellee, without a cross-appeal, can present only a matter appearing in the record because otherwise, the appellant will fail to "have fair notice regarding the grounds on which the appellee intends to defend the judgment." *Baatz v. Columbia Gas Transmission, LLC*, 929 F.3d 767, 775 (6th Cir. 2019). An appellee should seek a cross-appeal rather than present an alternative ground if the appellee seeks "more than it obtained by the lower-court judgment." *United States v. Burch*, 781 F.3d 342, 343-44 (6th Cir. 2015). For example, the Court in *United States v. Boumelhem* disregarded an appellee's alternative argument when it was a new ground not claimed in the trial court, "and consequently[,] the record is not developed with regard" to that alternative ground. 339 F.3d 414, 428 (6th Cir. 2003); *Boggio v. USAA Fed. Sav. Bank,* 696 F.3d 611, 623 (6th Cir. 2012); *Hunter v. United States*, 160 F.3d 1109, 1114 (6th Cir. 1998) (holding government forfeited reliance on ground "since the government failed to raise the appeal-waiver issue below [and] we do not have before us any factual finding by the district court to the effect").

Because this position was not raised in the court below, neither party developed evidence concerning the possibility of extinguishment or whether the proceeds due to SRLC would be insufficient to protect conservation purposes in

perpetuity, assuming §170(h) required such compensation. The Commissioner attempts to remedy this failure by presenting – for the first time – Zillow real estate data and census information, claiming such information shows that the proceeds guaranteed to SRLC by Oakbrook's deed are insufficient.[10] However, no evidence was presented demonstrating that condemnation was likely to occur, or specifically, one that would take the entire easement-protected property. Such evidence is relevant to whether, at the time of donation, the possibility SRLC will be insufficiently compensated was so remote as to be negligible. Treas. Reg. §1.170A-14(g)(3). And while the Commissioner posits a universe of scenarios in which the post-condemnation compensation to SRLC under Oakbrook's easement will be less than the amount due under the Commissioner's interpretation of the Regulation (and now, statute), there is also a universe of scenarios in which the compensation to SRLC under Oakbrook's easement will be ***more*** than the amount SRLC would receive under the Commissioner's position. (JA394-95, 406-07).

SRLC crafted a provision that it viewed as exceeding the minimum required by the Regulation. In SRLC's experience, "condemnation on conserved property . . . is almost invariably [limited to] a portion of the property rather than the entire

[10] Courts do not take judicial notice of Zillow data for a host of reasons. *See* Jeffrey Bellin & Andrew Guthrie Ferguson, *Trial by Google: Judicial Notice in the Information Age*, 108 Nw. L. Rev. 1137, 1179 (2014).

parcel." SRLC Br. 13. Using the Regulation's ratio, "rather than a definitive amount, actually harms the donee." *Id.*

In sum, SRLC received not only legal enforcement rights, but also post-condemnation proceeds that it determined were necessary to protect the conservation purposes in perpetuity. (JA394-95). Judge Holmes in his Memorandum Opinion and the Tax Court majority found this sufficient to meet §170(h)'s requirements. The Commissioner's newfound statutory analysis, which contravenes his own Regulation, is a bridge too far and does not support disallowing Oakbrook's deduction.

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

This Court has previously expressed concern that Treasury does "not have a great history of complying with APA procedures." *CIC Serv., LLC v. I.R.S.*, 925 F.3d 247, 258 (6th Cir. 2019), *rev'd*, No. 19-930, 2021 WL 1951782 (2021) (internal quotations omitted).[11] This case presents a prime example. It is undisputed that Treasury received multiple comments directly addressing the proposed Proceeds Regulation, which were not answered - or even acknowledged - in the preamble to the final regulations. It is also undisputed that the preamble does not explain, or

[11] On May 17, 2021, the Supreme Court reversed the Sixth Circuit's decision that the action was properly dismissed, holding that the Anti-Injunction Act did not preclude CIC Services from pursuing its APA challenge.

even mention, the Proceeds Regulation. The Commissioner's attempts to limit Oakbrook's right to challenge Treasury's procedural shortcomings or minimize Treasury's responsibility to respond to comments is nothing but smoke and mirrors, advanced in an effort to obscure a clear case APA noncompliance.[12]

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

The Commissioner's suggestion that Oakbrook cannot challenge the procedural validity of the Regulation, which formed the basis of the IRS's disallowance, is meritless. *See* IRS Br. 41-42.[13] In failing to address the multitude of comments concerning the Proceeds Regulation (including failing to address the Regulation at all), Treasury deprived all regulated parties, including donors and donees, of the reasoned analysis necessary to comply with the Regulation. Treasury also deprived the Court of any record to review. The APA invalidates unexplained agency actions for this very reason. *See Simms v. Nat'l Highway Traffic Safety Admin.*, 45 F.3d 999, 1004-05 (6th Cir. 1995) (holding that a court must substantially

[12] The Court need only compare the preamble (JA643-45) to the comments found at JA670-72, 764-66, 778-79, 795 to conclude that Treasury failed to comply with APA procedures.

[13] The Commissioner's claim that this Court's review of all 13 comments concerning the Proceeds Regulation could expose other portions of the §170(h) regulations to challenge (IRS Br. 42) is neither accurate nor is it a proper basis for foreclosing an APA challenge to the Regulation, which is the basis for the Commissioner's disallowance.

review and not merely rubber stamp an agency decision); *Home Box Office, Inc. v. F.C.C.*, 567 F.2d 9, 35 (D.C. Cir. 1977) ("*HBO*") (holding the APA's "procedural requirements are intended to assist judicial review as well as to provide fair treatment for persons affected by a rule"). It makes no difference whether any of the comments directly suggested using a fixed value.[14] No response to any comment and no explanation for the Regulation renders it invalid.

The APA states that when reviewing an agency action, "the court shall review the whole record." 5 U.S.C. § 706. Thus, this Court can and should review Treasury's failure to consider ***all*** significant comments. In *St. James Hospital v. Heckler*, 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 1460, 1466, 1469-70 (7th Cir. 1985) (emphasis added).[15] Even the Tax Court majority in *Oakbrook* reviewed all 13 comments. 154 T.C. at 186-89.

[14] Notably, comments suggested to remove the requirement altogether, or to allow for allocation decisions to be made on a case-by-case basis. (JA672, 778-79). Adoption of either proposal would remove the basis for disallowing Oakbrook's deduction.

[15] This Court adopted *St. James* in *Cumberland Medical Center v. Secretary of Health & Human Services*, 781 F.2d 536, 538 (6th Cir. 1986).

The comments addressing 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. *See HBO*, 567 F.2d at 35. Otherwise, the "opportunity to comment is meaningless." *Id.*

The Commissioner admits that commenters advocated for proportionate value over absolute value, suggested or requested clarifications concerning the formula's elements, and requested that the proportionate value be the minimum required. *See* IRS Br. 43; (JA685, 699, 717, 721). In response, Treasury gave no explanation for the final formula it chose, gave no indication whether the proportionate value was an absolute or minimum requirement, and never mentioned why it rejected alternatives, such as a case-by-case basis. Instead, Treasury said nothing. (*See* JA643-45).

SRLC's executive director testified at trial that, because the Regulation designated the proportionate value as a minimum, a fixed value was allowed under the Regulation since "it always exceeds what the IRS reg, minimum required by the IRS reg." (JA406). Had Treasury specified why (or even whether) it viewed the Regulation's fractional value as providing ***more*** compensation than a fixed amount, Oakbrook and SRLC would have had a better understanding of the Regulation's requirements.

Likewise, a response to the New York Landmarks Conservancy's ("NYLC") detailed comment concerning how the proposed regulation potentially fails to account for post-donation improvements would have impacted how Oakbrook's deed, and thousands of others, were drafted. The absence of such a response led the IRS to conclude in September 2008, months before Oakbrook's donation, that the Regulation excludes proceeds attributable to post-donation improvements. I.R.S. Priv. Ltr. Rul. 2008-36-014, 2008 WL 4102748 (Sept. 5, 2008). The APA requires an explanation for an agency rule to avoid this very type of widespread misunderstanding.

Finally, concluding that Oakbrook's challenge to Treasury's APA procedural shortcomings is limited to only certain unaddressed comments will lead to tremendous judicial inefficiency. Under this standard, a decision that a regulation is valid would not foreclose a future challenge to the procedural validity of the same regulation by another party whose circumstances are reflected in other, unaddressed comments that were inapplicable to the previous challenger. Moreover, sequestering procedural challenges to specifically-impacted parties is inconsistent with the APA's requirement that the court review "the whole record." In sum, Treasury's failure to respond to the collective objections raised to the proposed Regulation violates the APA, rendering the Regulation invalid.

B. Multiple comments addressing the Proceeds Regulation are significant.

In this Court, basis and purpose statements must enable the reviewing court to see the substantive issues and "why the agency reacted to them as it did." *Simms*, 45 F.3d at 1005 (citing *Auto. Parts & Accessories Ass'n v. Boyd*, 407 F.2d 330, 338 (D.C. Cir. 1968)). The agency must also "give reasoned responses to all significant comments in a rulemaking proceeding." *PPG Indus. v. Costle*, 630 F.2d 462, 466 (6th Cir. 1980). With the Proceeds Regulation, Treasury did neither. The Commissioner's claim that comments submitted by NYLC and others were not significant strains credulity when the Commissioner has heavily relied on the Proceeds Regulation to deny scores of easement deductions. *Oakbrook*, 154 T.C. at 227 (Toro, J., concurring).

Initially, the Commissioner argues that NYLC's comment is not significant because the improvements provision in Oakbrook's deed is different from the provision in the deed at issue in *Hewitt v. Commissioner*, No. 20-13700 (11th Cir. filed Sept. 15, 2020). IRS Br. 45-46. However, the different manners in which these parties crafted their deeds to comply with an ambiguous Regulation is irrelevant to whether the comment is significant. Moreover, the Tax Court rejected the Commissioner's position that the improvements language in Oakbrook's deed could result in the donee receiving nothing upon extinguishment. Mem. Op. at *30, *35. Instead, the correct reading is that "[t]he value of any improvements would be

subtracted from any condemnation award only if it was specified in that [judicial] award." *Id.* at *35. [16] The removing of post-donation improvement proceeds is precisely what the deed at issue in *Hewitt* does.[17]

Several comments addressing the Regulation, in addition to NYLC's, are relevant and significant, meriting Treasury's response. Judge Holmes described how the comments 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).

For example, NYLC directly addressed how the proposed regulation was unreasonable:

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[16] The Commissioner also overstates the potential value of improvements. IRS Br. 38-39. Aside from four homesites, the improvements could not take up, in the aggregate, more than 25,000 square feet of ground cover, or just over ½ an acre. (JA115). Therefore, these collective improvements are less than 1% of the conserved property and require SRLC's approval for any structure that costs more than $10,000. (JA115).

[17] Oakbrook's deed requires that amounts separately awarded for post-donation improvements should be subtracted from the overall proceeds because if the donee "were to keep the award that took those improvements into consideration, the land trust would be getting unjust compensation because we didn't pay for those." Mem. Op. at *34; (JA391).

> 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**.

(JA670) (emphasis added). In so doing, NYLC cast doubt on the rule's reasonableness, which (1) deters conservation, and (2) "fails to take into account that improvement may be made . . . which should properly alter the ratio." (JA671). Additionally, NYLC offered concrete suggestions that the regulation be removed or that the "formula be revised to prevent such inequities." (JA672). *Contra* IRS Br. 48-49.

In dismissing these comments, the Commissioner confuses a "significant comment" requiring a response with a comment that raises a "significant issue," calling into question the Regulation's reasonableness. In both cases relied upon by the Commissioner, the court concluded the rule was reasonable, notwithstanding comments that the agencies ***addressed***. *See* IRS Br. 47-48. In *Hussion v. Madigan*, the agency "summarized the positions urged by opponents and proponents before issuing its final rule." 950 F.2d 1546, 1549 (11th Cir. 1992). In *Navistar International Transportation Corporation v. E.P.A.* the regulation's basis and purpose statement specifically addresses each comment and provides the regulation's rationale. 941 F.2d 1339, 1350-52 (6th Cir. 1991); Approval and Promulgation of Implementation Plans; Ohio, 54 Fed. Reg. 37795-02, 37795-99

(Sept. 13, 1989). Treasury's failure to address comments here is stark in comparison.

Treasury's failure to respond to several relevant and significant comments renders the Regulation procedurally invalid. Leaving significant 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. *See HBO*, 567 F.2d at 35 n.58. Therefore, the dual purposes served by the APA are unmet.

C. 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. 49; 154 T.C. at 192. 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 law. IRS Br. 49-50.[18]

[18] The Commissioner claims that the preamble "discuss[ed] the statutory protected-in-perpetuity requirement in a way that illuminates its rationale for that rule" but cites only to the requirement that a mortgagee subordinate its rights to the donee. IRS Br. 50-51. That discussion is totally unrelated to extinguishment. In fact, the easement's extinguishment would reinstate the mortgagee's subordinated interest.

The applicable caselaw is clear. An agency must give reasons for its actions and reasoned responses to all significant comments. *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2127 (2016); *PPG*, 630 F.2d at 466 (holding that a court is not required "to take the agency's word that it considered all relevant matters," especially when the administrative record shows no such consideration, but instead, shows consideration "in conclusory fashion in argument before this Court"); *Indus. Union Dep't, AFL-CIO v. Hodgson*, 499 F.2d 467, 475-76 (D.C. Cir. 1974).

The Commissioner essentially asks this Court to conclude that a discussion about mortgage subordination and clarifying edits to the proposed regulation addressed: (1) challenges to the Regulation's wording (JA682, 689, 764-66, 778); (2) confusion surrounding improvements (JA671); (3) whether the Regulation will create adverse conservation incentives (JA670-72, 675, 773, 778); (4) whether the allocation is enforceable against subsequent landowners (JA795); and (5) whether the Regulation is superfluous or superseded by other applicable rules (JA685, 779, 795, 798). In reality, neither the preamble nor the clarifying changes to the Regulation address these issues or show what considerations Treasury found persuasive. Thus, neither satisfy the APA's procedural requirements.

III. The Regulation Is Arbitrary and Capricious

The APA directs courts to "hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion,

or otherwise not in accordance with law." 5 U.S.C. §706(2)(A); *Ky. Riverkeeper, Inc. v. Rowlette*, 714 F.3d 402, 407 (6th Cir. 2013). The Supreme Court in *Motor Vehicle Manufacturers v. State Farm* outlined the steps an agency must take to overcome the "arbitrary and capricious" standard in the APA:

> [T]he 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, 43 (1983) (internal quotations omitted) (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 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. 52. This approach is overly simplistic and inaccurate. The Supreme Court, Sixth 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; *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"); *Cumberland*,

781 F.2d at 538. Given the high level of deference under *Chevron,* it is axiomatic that the agency must engage in reasoned decisionmaking as contemplated by *State Farm.*

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* JA643-45). Nothing in the administrative record explains 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. (JA643-45, 671, 675, 685, 779, 795, 798).

First, the Commissioner argues that Treasury needed no reason for its regulatory requirement because the Regulation is a policy decision, rather than based on empirical evidence. IRS Br. 53-54. 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*, 136 S. Ct. at 2127 (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)); *Hodgson*, 499 F.2d at 476.

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 *Hodgson*, 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 adopting the Proceeds Regulation, "[w]hat we hear is the chirping of crickets." *Oakbrook*, 154 T.C. at 239 (Holmes, J., dissenting). Such omissions cannot satisfy the "necessary minimum" upon which courts must insist.[19]

Next, the Commissioner contends that Treasury's lack of a reason for its rule is not fatal because no commenter advocated the fixed-value approach. IRS Br. 54. Not only does the Commissioner mischaracterize the comments, but he misses the mark altogether. *State Farm* is clear that agencies must engage in reasoned decision-making when crafting their rule, a requirement not conditioned on the comments' scope or substance. Moreover, commenters ***suggested*** that donees be provided flexibility to craft provisions on a case-by-case basis. (JA779). Consistent with these

[19] *Altera Corporation v. Commissioner* is inapposite on this point because Treasury at least acknowledged it was adopting a policy that rendered certain comments irrelevant. 926 F.3d 1061, 1081 (9th Cir. 2019). Here, Treasury doesn't even meet that low bar.

suggestions, SRLC crafted a provision that, in its view, ***exceeded*** the minimum required by the Regulation. Commenters also suggested that this requirement be removed altogether, which obviates the basis upon which Oakbrook's deduction was disallowed. (JA672, 798). Treasury offered no reason for its rule or why these alternatives were rejected. Accordingly, Treasury's Regulation is not the product of reasoned decisionmaking, rendering it invalid under the APA and *State Farm.*

Finally, the Commissioner attempts to shore up Treasury's failure to offer a reasonable basis for its rule by presenting his own bevy of reasons to support Treasury's decision, such as the preference for "an easily administrable, bright line rule"[20] and concerns about donors having "a powerful incentive to overvalue the improvements." IRS Br. 61. 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).

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[20] The Commissioner's suggestion that the Regulation creates an "easily administrable, bright-line rule" (IRS Br. 61) 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, 206-07 (5th Cir. 2018); *Oakbrook*, 154 T.C. at 208-12 (Toro, J., concurring); Mem. Op. at *22; I.R.S. PLR 2008-36-014.

Given the Regulation's ambiguities, a donee organization would face just as much difficulty having a state court interpret the "bright line" rule in the Regulation as taxpayers are facing today.

The Supreme Court recently confirmed the "important values" served by precluding *post hoc* rationalizations like those offered in this case: "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*.

Without any contemporaneously articulated reasons to support the Regulation, the Commissioner cannot demonstrate that it is the product of reasoned decisionmaking.[21] Consequently, the Regulation is an arbitrary and capricious agency action that must be set aside regardless of whether it could satisfy *Chevron* step two. 5 U.S.C. §706(2).

[21] The Commissioner's suggestion that the Regulation's age demonstrates its reasonableness conflicts with his acknowledgment on the following page that the IRS did not previously enforce the Regulation in this manner. *Compare* IRS Br. 63 to Br. 64 (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 (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.").

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

As a preliminary matter, a regulation that is a permissible interpretation of the statute can nevertheless be invalid under the APA because "the agency's action may still be 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law.'" *Atrium Med. Ctr. v. U.S. Dep't of Health and Human Servs.*, 766 F.3d 560, 567 (6th Cir. 2014) (quoting 5 U.S.C. §706(2)(A)). The "arbitrary and capricious" review imposed by the APA ensures "'that agencies have engaged in reasoned decisionmaking.'" *Id.* (quoting *Judulang v. Holder*, 565 U.S. 42, 53 (2011)). Because no reasonable basis was offered by Treasury for its Regulation, *Chevron* is inapplicable. *Encino*, 136 S. Ct. at 2127.

The Regulation can also be set aside as unreasonable even if it constitutes a permissible statutory interpretation. "This Court has firmly rejected the suggestion that a regulation is to be sustained simply because it is not 'technically inconsistent' with the statutory language." *United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 26 (1982).[22] Likewise, the D.C. Circuit recently invalidated a Treasury Regulation that the court concluded was unreasonable under *Chevron*. *Good Fortune Shipping SA v. Comm'r*, 897 F.3d 256, 262, 266 (D.C. Cir. 2018). The Regulation here is unreasonable in several respects, as described at length by Judge Toro and Judge

[22] The Supreme Court reached this conclusion, applying the standard of deference set forth in *Nat'l Muffler Dealers Ass'n, Inc. v. United States,* 440 U.S. 472, 477 (1979), which is a less deferential than *Chevron.*

Holmes. *Oakbrook*, 154 T.C. at 213-15, 254-58 (Toro, J., concurring) (Holmes, J., dissenting).

Finally, the fact that conservation easement donations have had the same or similar language in easement deeds for over 30 years without any challenge by the Commissioner suggests that the Regulation is not a reasonable interpretation of the statute. *Christopher*, 567 U.S. at 158 (observing that "while it may be possible for an entire industry to be in violation of the FLSA for a long time without the Labor Department noticing, the more plausible hypothesis is that the Department did not think the industry's practice unlawful") (internal quotations omitted).

CONCLUSION

Denying deductions to donors who protected millions of acres based on a Regulation that is not the product of reasoned decisionmaking is clearly inconsistent with a statute enacted to incentivize conservation. Allowing the Regulation to stand when no reasons for its issuance were offered, and when the Commissioner's current efforts to enforce it only discourage conservation, renders the APA, and its protections, meaningless. Therefore, the decision of the Tax Court is due to be reversed.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type-volume limitations set forth in Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedures. This brief uses Times New Roman 14-point typeface and contains 6,482 words.

/s/MICHELLE ABROMS LEVIN
Michelle Abroms Levin

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on May 21, 2021, I electronically filed the foregoing 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 or 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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