Jack Straw Fortnightly*

old brown shoe

Back in July 2020, in Jack Straw three comma seven, we discussed an advice memo two lawyers in the chief counsel's office had sent to senior lawyers at SB/SE and TE/GE concerning a "marketed structure" they were investigating,

involving something resembling a charitable remainder annuity trust, which the promoters said would somehow "trap" realized gains and distribute mostly what one might call "fourth tier" return of corpus.

The memo outlined several features of the "structure" that would not in fact operate the way its promoters said it would, and your correspondent identified a few others.

The other shoe has now dropped.

A couple weeks ago, the Justice Department filed suit in a federal district court in western Missouri, seeking

(a) to enjoin the promoters, together with a couple of lawyers and accountants who have been facilitating this scheme, from ever again having anything at all to do with tax advice or tax reporting,

(b) to require the promoters to disclose the names of every "customer" who participated in this scheme, every beneficiary of every annuity trust, and every return preparer, apart from the defendants already named, who prepared trust returns, and

(c) to require the defendants to disgorge every nickel they made promoting these transactions over something like six or seven years.

Jack observes that while this is literally a mom and pop operation,[1] apparently pitched primarily to farmers, the complaint alleges there were as many as seventy of these trusts created, and that the nineteen already audited involved underreporting of more than $17 million in taxable income.

Altogether, the complaint alleges underreporting across all seventy trusts may total $40 million, resulting in revenue losses of more than $8 million.

serious money

Which pales in comparison to the $1.3 billion in "false and fraudulent deductions" alleged to have been claimed in connection with a syndicated conservation easement scheme -- based in Georgia, where else? -- reaching back more than twenty years and involving a couple dozen projects,

as to which the Justice Department has now filed a "superseding" criminal indictment, naming several additional co-conspirators and adding about sixty pages to the complaint filed last year, much of it apparently derived from the cooperation of co-conspirators who pleaded guilty to related charges in December 2020, see Jack Straw four comma one.

Meanwhile the Ecovest litigation continues to drag on, now entering its fourth year.

About a year ago, the first named individual defendant consented to the entry of a stipulated judgment against her, under which she paid some undisclosed amount in settlement of the penalty and disgorgement claims and submitted to a permanent injunction barring her from having anything further to do with promoting conservation easements.

Now pending are cross motions for partial summary judgment, which might at least narrow the issues somewhat. Unless they don't.

Jack notes with interest that the appraiser who is at the center of the Ecovest controversy has acknowledged in deposition testimony that he valued the subject parcels of raw land **as though they had already been developed** to their supposed "highest and best use" as residential properties --

-- without, in other words, accounting for the expense that would have been required to develop the properties.

Unfortunately, the appraiser may have a certain amount of cover for taking this position, in the form of a 2009 Tax Court memorandum decision that seems at least superficially to have accepted this approach -- from this very appraiser, no less.

one step back

Jack wants to say we are not planning to give a lot of space in these pages to the substantive nuances of the permanent IRS war on conservation and facade easements as it is playing out in the Tax Court and the appeals courts, improvements clauses and whatnot, as these are sort of a niche concern to maybe a handful of our readers.

But the larger perspective, that **any edge the tax code might afford** to one characterization of a transaction over another **can be fertile ground for schemers**, is a recurring theme in these pages.

In this instance the charitable deduction **against ordinary income** for a contribution of **appreciated property on which gain has not been recognized**, but really any edge --

-- debt versus equity, recognition versus non, ordinary versus capital, disregarded versus separate entity, this year or next, incomplete versus completed gift, you name it.

But staying with syndicated conservation easements for a moment. Jack was about to say we are still awaiting a result from the 6th

Circuit federal appeals court in *Oakbrook Land Holdings*, but here it is in this morning's feed.[2] Let's have a look.

And we have a split of authority, what fun.

The 6th Circuit affirms the Tax Court in sustaining the validity of the "proceeds" regulation, where the 11th Circuit in *Hewitt* had reversed. With a surprise or two along the way.

Jack has been saying *Oakbrook* was not a good vehicle for testing the validity of the regulation as it affects post-contribution improvements, because the proceeds clause at issue simply freezes the value of the easement at the date of contribution.

But the author of the majority opinion says IRS did not raise that argument in its briefing to the lower court, so it is not preserved for appeal.

Jack grumbles that this is yet another instance in which tax law journalism is frustrated by the fact that only a handful of orders and no briefs are posted to the Tax Court's online dockets. Certainly the issue was mentioned in Judge Toro's concurring opinion below.

But be that as it may. Apparently we are going to focus entirely on the process by which reg. section 1.170A-14(g)(6)(ii) was finalized.

The majority opinion says the requirement of (g)(6)(ii) that the grantee of the easement share in extinguishment proceeds attributable to post-contribution improvements is justified by the need for a readily "administrable rule," favoring perpetuity over the tax incentive. And the comments to the contrary to which IRS did not directly respond in finalizing the regs were either "not significant" or not to the point.

And here actually we do have a divergence of views, with one member of the panel concurring in the result only,

on the ground that by freezing the value of the easement at the date of contribution Oakbrook had in effect reserved a reversion, defeating the perpetuity requirement, whether IRS had preserved the issue or not,

while agreeing with the 11th Circuit in *Hewitt* that the agency had ignored "significant" public comments on the proposed regs without adequate explanation.

Jack says this disagreement among the panel would not support a motion for rehearing, but it might eventually figure in a petition for *certiorari* to the Supreme Court.

In the meantime, the Tax Court has literally hundreds of these cases held in abeyance, pending the results in *Hewitt* and now *Oakbrook*. Many that would be appealable to the 11th Circuit may have to go to trial on valuation.[3]

tax exceptionalism

Also from the 6th Circuit, we have an opinion in *Mann Construction* saying IRS exceeded its authority in issuing Notice 2007-83, which identifies as a "listed transaction" the use of an employee welfare benefit plan to purchase cash value life insurance policies.

Again, not to get into substantive details in areas outside the immediate concerns of this newsletter, but the issue here does have to do more generally with **the procedures by which IRS develops formal guidance.**

Attentive readers might recall that in Jack Straw four comma nine we updated the status of *CIC Services*, on remand from the Supreme Court having reversed both the 6th Circuit and the trial court on the question whether Notice 2016-66, dealing with microcaptives, was a "legislative" rather than an "intepretive" rule, which would have required an opportunity for public comment.

At the time, Jack said that particular Notice

> does not in itself, technically, characterize the microcaptive transaction as a "shelter." It identifies the agency's concern that in some cases it may be, it requires material advisors to report various data points that might enable the agency to launch a regulatory project, and it actually does invite public comment on "how the transaction might be addressed in published guidance."

And he added,

> With the enactment of section 6707A(c)(1) in 2004, Congress expressly empowered IRS to make these inquiries.

But the Notice at issue in *Mann Construction* is different.

Here, IRS is openly declaring that "the tax benefits claimed for these arrangements **are not allowable**," that **these flatly are "tax avoidance transactions," not just "may be."** In other words, this is a "listed transaction," not merely a "transaction of interest." So notice and comment might be required, we will find out.

lo-fi house

The House has concurred in the Senate amendment to the appropriations bill for the fiscal year ending September 30, and once again we have language forbidding IRS and Treasury to launch a regulatory project, quote,[4]

> relating to the standard which is used to determine whether an organization is operated exclusively for the promotion of social welfare for purposes of section 501(c)(4),

again expressly referencing the proposed regs from 2013 that were withdrawn in the face of what Jack has previously described as

> an unprecedented avalanche of adverse public comment, much of it angry and ill-informed, cribbed from a handful of talking points provided by a few provocateurs.

and requiring IRS in determining the exempt status of a (c)(4) applicant to continue to employ "the standard and definitions as in effect on January 1, 2010" which is apparently an arbitrary date, but would seem to reference the eleven factors set out in Rev. Rul. 2004-06.

Jack has elsewhere noted the irony that in its suit for a declaratory judgment that it does qualify for (c)(4) status, the "tea party" org

Freedom Path has argued that this revenue ruling is unconstitutionally vague.

The org filed a motion for summary judgment on its amended petition last April, but the case stalled when Judge Ketanji Brown Jackson was elevated to the DC Circuit appeals court bench in July.

meanwhile

Rep. Bill Pascrell, Jr. (D-NJ), who chairs the Oversight subcommittee at Ways and Means, has written Treasury Secretary Janet Yellen urging her to relaunch a regulatory project to clarify that assets held in an intentionally defective grantor trust do not get a basis adjustment at the settlor's death.[5]

The question was placed on the "no rule" list late in 2015, category 5, "areas under study" for formal guidance, and it was carried on priority guidance plans thereafter until this year, when it was dropped.

There is a chief counsel memo out there, CCA 200937028, emphatically stating the position that you get a basis adjustment **only if you have estate tax inclusion.** But there is also a more recent letter ruling, PLR 201245006, which seems to imply the contrary.

Prof. Daniel Hemel of the University of Chicago law school has written an excellent article on the subject in the form of a letter to Rep. Pascrell, supplementing his testimony at a subcommittee hearing last December.

In that letter, Prof. Hemel argues that we need formal guidance here in order to impose a requirement that anyone claiming a basis adjustment at the death of the settlor of an IDGT file a form 8275-R, disclosing that they are asserting **a position contrary to published regulations.**

This reasoning is incorporated in Rep. Pascrell's letter to Ms. Yellen.

and finally

The section 7520 rate for April is up another twenty basis points to 2.2 percent, the highest rate in over two years. The two-month lookback to February affords a spread of sixty basis points.

In the case of a gift annuity, there are tradeoffs between the amount of the charitable deduction and the portion of the annuity payout taxed as ordinary income.

Taking the specific case of an annuitant aged 72, and setting the payout at the ACGA recommended rate of 4.9 percent, paid quarterly

(a) with the section 7520 rate at 2.2 percent, the charitable deduction would be 46.925 percent, while the ordinary income component of the annuity payout would be 25.3 percent, while

(b) with the section 7520 rate at 1.6 percent, the charitable deduction would be 44.374 percent, while the ordinary income component of the annuity payout would be 21.7 percent,

over an expected return multiple of 14.5 years.

Attentive planners will want to balance these considerations.

dust kittens

[1]

The Eickhoffs went through an uncontested divorce in late 2019, early 2020, possibly as a result of their difficulties with IRS.

Jack is curious how they happened to hook up with lawyers in Alabama and Minnesota, rather than, say, Boone County, Missouri to further this scheme.

Jack also observes that the statement is made repeatedly throughout the complaint that a charitable remainder annuity trust is required to file not only a form 5227 but also a form 1041. This is simply not true.

Possibly what the lawyers who drafted the complaint intended to say is that a nonqualified trust would be required to file a 1041, rather than a 5227. And to pay tax on undistributed realized gains.

Or possibly they are poorly informed.

[2]

"This morning" being Monday, 14 March 2022.

[3]

See order dated 02/23/22 in *Cub Creek Preserve*, order dated 02/25/22 in *Montgomery-Alabama River*, and order dated 02/28/22 in *Corning Place Ohio*, issued as T.C.Memo. 2022-12.

[4]

The quoted text appears on page 498 of the linked document.

[5]

Some readers might recall that Jack spent a page and a half in issue four comma seven disparaging the suggestion that assets in an IDGT should get a basis adjustment at the settlor's death, going so far as to suggest that the proponents of this idea do not themselves believe in it.

Jack says, I know a fireman who looks after the fire