Current Federal Tax Developments

Week of January 3, 2022

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WEEK OF January 3, 2022
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SECTION: 170
ELEVENTH CIRCUIT HOLDS IRS REGULATION ON JUDICIAL EXTINGUISHMENT FORMULA FOR CONSERVATION EASEMENT DEDUCTIONS INVALID

Citation: Hewitt v. Commissioner, Case No. 20-13700, (2021 CA11), 12/29/21

The Eleventh Circuit Court of Appeals has ruled invalid a portion of regulations adopted in 1986 related to contributions of conservation easements in the case of *Hewitt v. Commissioner*.[1] The issue involved the Tax Court's finding, which the appellate panel overruled, that the easement failed to satisfy the "protected-in-perpetuity" requirement found at IRC §170(h)(5), as it violated the judicial extinguishment formula found at Reg. §1.170A-14(g)(6)(ii). The panel found that Treasury had violated the Administrative Procedures Act by failing to address comments provided on this issue as part of issuing the regulations in final form.

The panel begins by noting the Eleventh Circuit had recently found in favor of the IRS on a similar easement in the case of *TOT Property Holdings, LLC v. Commissioner*, 1 F.4th 1354, 1363 (11th Cir. 2021) but the panel notes that in that case they had not considered the issue of the regulation's validity as the taxpayers had conceded the matter in that case. But in this case the taxpayers were challenging the regulation's validity, not just the IRS's interpretation of that regulation:

> …[B]ased on the taxpayers' concession in *TOT*, *id*. at 1362 & n.13, we did not address whether § 1.170A-14(g)(6)(ii) was procedurally valid under the Administrative Procedures Act ("APA") or substantively valid under the framework in *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc*., 467 U.S. 837 (1984). Unlike the taxpayers in *TOT*, the Hewitts challenge the regulation's validity on appeal. Specifically, the Hewitts argue that the Commissioner's interpretation of § 1.170A-14(g)(6)(ii) — prohibiting the subtraction of the value of post-donation improvements to the property on which a conservation easement exists from the proceeds in the event of judicial extinguishment — is arbitrary and capricious for violating the procedural requirements of the APA, see 5 U.S.C. § 706, because the U.S. Treasury Department failed to respond to significant comments as to the improvements issue in promulgating the regulation. The

[1] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), *reversing* TC Memo 2020-89, December 29, 2021, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/eleventh-circuit-finds-easement-deduction-reg-is-invalid/7cr4t (retrieved December 30, 2021)

> Hewitts further argue that the regulation is substantively invalid under Chevron as an unreasonable interpretation of the statute.[2]

Ultimately the panel chose to issue a decision solely based upon the IRS's failure to consider comments on the issue, leaving unanswered the question of whether the regulations the IRS arrived at were an unreasonable interpretation of the statute.

The regulation in question reads as follows:

> (i) In general. If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation under this paragraph can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds (determined under paragraph (g)(6)(ii) of this section) from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.
>
> (ii) Proceeds. . . . [F]or a deduction to be allowed under this section, at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time. . . . For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant. Accordingly, when a change in conditions give rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(i) of this section, the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.[3]

The panel summarized the provisions of the Administrative Procedures Act that were in question here:

> The APA "prescribes a three-step procedure for so-called 'notice-and-comment rulemaking.'" *Perez v. Mortg. Bankers Ass'n*, 575 U.S. 92, 96

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[2] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), December 29, 2021

[3] Reg. §1.170A-14(g)(6)

> (2015); accord 5 U.S.C. § 553. First, an agency "must issue a '[g]eneral notice of proposed rulemaking,' ordinarily by publication in the Federal Register." Perez, 575 U.S. at 96 (alteration in original) (quoting § 553(b)). Second, "if 'notice [is] required,' the agency must 'give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments,'" and the agency "must consider and respond to significant comments received during the period for public comment." Id. (alteration in original) (quoting § 553(c)). Third, in promulgating the final rule, the agency "must include in the rule's text 'a concise general statement of [its] basis and purpose.'" *Id.* (alteration in original) (quoting § 553(c)). As the Supreme Court has explained, "Rules issued through the notice-and-comment process are often referred to as 'legislative rules' because they have the 'force and effect of law.'" Id. (quoting *Chrysler Corp. v. Brown*, 441 U.S. 281, 302–03 (1979)).
>
> Thus, "[t]he APA requires the agency to incorporate into a new rule a concise general statement of its basis and purpose." *Lloyd Noland*, 762 F.2d at 1566. As we have explained, "statement[s] may vary, but should fully explain the factual and legal basis for the rule." *Id*. Indeed, "[b]asis and purpose statements must enable the reviewing court to see the objections and why the agency reacted to them as it did," id., as "[o]ne of the basic procedural requirements of administrative rulemaking is that an agency must give adequate reasons for its decisions," *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016). And, in the statement, the agency must rebut "vital relevant" or significant comments. See *Lloyd Noland*, 762 F.2d at 1567; *Hussion v. Madigan*, 950 F.2d 1546, 1554 (11th Cir. 1992) ("Under the 'arbitrary and capricious' standard of review, an agency is . . . required to respond to significant comments that cast doubt on the reasonableness of the rule the agency adopts." (quoting Balt. Gas & Elec. Co. v. United States, 817 F.2d 108, 116 (D.C. Cir. 1987))). The purpose of notice-and-comment rulemaking is to "give[ ] affected parties fair warning of potential changes in the law and an opportunity to be heard on those changes" while "afford[ing] the agency a chance to avoid errors and make a more informed decision." Azar v. Allina Health Servs., 139 S. Ct. 1804, 1816 (2019).[4]

After Treasury issued the proposed regulations, the agency received over 700 pages of commentary from 90 organizations and individuals, with 13 addressing the extinguishment proceeds regulation.[5]

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[4] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), December 29, 2021

[5] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), December 29, 2021

The comment the opinion focuses most closely on came from the New York Landmarks Conservancy (NYLC):

> Turning to the most detailed comment, the New York Landmarks Conservancy ("NYLC") urged Treasury to delete the proposed proceeds regulation because it contained pervasive "problems of policy and practical application." NYLC stated that while Congress enacted the statute "to encourage the protection of [the] . . . environment through the donation of conservation restrictions," the proposed regulation "would thwart the purpose of the statute by deterring prospective donors," as those donors would "likely . . . be discouraged from making a donation which may tie themselves or future owners to share proceeds of a sale or exchange with the charitable organization [donee] under circumstances which cannot possibly be foreseen." NYLC explained that prospective donors frequently were concerned about "perpetuity" issues, which were "mollified upon the donor's recognition that common law permits the extinguishment of restrictions when they no longer serve the original intended purposes." But NYLC believed "[t]he prospect of extinguishment would no longer mollify these fears if a split of proceeds under unknown circumstances would be required." As such, and because "the possibility of extinguishment is relatively remote," NYLC stated it was "unnecessary" for Treasury "to provide for allocation of proceeds after extinguishment."
>
> NYLC also specifically commented on the issue of whether the value of post-donation improvements to the easement property should be included or excluded from the extinguishment proceeds formula contained in the regulation. NYLC stated that the regulation's structure "contemplates that a ratio of value of the conservation restriction to value of the fee will be fixed at the time of the donation and will remain in effect forever thereafter." But NYLC asserted that the formula "fail[ed] to take into account that improvements may be made thereafter by the owner which should properly alter the ratio." In support of its concern, NYLC presented a mathematical example, which was based on a fact pattern in the proposed regulations, see 48 Fed. Reg. at 22,945, to show that requiring the prospective donor to turn over extinguishment proceeds attributable to post-donation improvements to the donee "would obviously be undesirable to the prospective donor and would constitute a windfall to the donee organization." See *Oakbrook*, 154 T.C. at 224 (Toro, J., concurring in result). Thus, "in light of the potential inequities," NYLC recommended "that the proposed proceeds formula be revised to prevent such inequities should the . . . Treasury decide to retain the

> provision" but "***strongly*** recommend[ed] deletion of the entire extinguishment provision." (emphasis added).[6]

The opinion goes on to note how Treasury did not deal with this and other related comments when issuing the final regulations:

> In the preamble to the final rulemaking, Treasury stated that "[t]hese regulations provide necessary guidance to the public for compliance with the law and affect donors and donees of qualified conservation contributions" and that it had "consider[ed] . . . all comments regarding the proposed amendments." Id. In the subsequent "Summary of Comments" section, however, Treasury did not discuss or respond to the comments made by NYLC or the other six commenters concerning the extinguishment proceeds regulation. See *id*. at 1497–98; *Oakbrook*, 154 T.C. at 188 ("The 'judicial extinguishment' provision is not among the amendments specifically addressed in the 'Summary of Comments.'"). And Treasury stated that "[a]lthough a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public comment procedure requirement of 5 U.S.C. [§] 553 [of the APA] did not apply." 51 Fed. Reg. at 1498.[7]

The opinion focuses on the following issue to determine if the regulation is to be upheld or thrown out:

> …[T]he issue before us is whether Treasury's failure to respond to NYLC's and the other commenters' concerns about the extinguishment proceeds regulation was in violation of the procedural requirements of the APA. Phrased differently, we must determine whether § 1.170A-14(g)(6)(ii), as interpreted by the Commissioner to prohibit the subtraction of any amount of proceeds attributable to post-donation improvements to the easement property in the event of judicial extinguishment, is procedurally valid under the APA where: (1) one commenter — NYLC — made specific comments raising the improvements issue as it relates to extinguishment proceeds and recommended deletion of the provision; (2) six other organizations submitted comments criticizing or urging caution as to the regulation; and (3) Treasury failed to specifically respond to any of those comments, instead simply stating that it had considered "all comments."[8]

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[6] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), December 29, 2021

[7] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), December 29, 2021

[8] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), December 29, 2021

The panel found that Treasury's failure to respond to these comments doomed the regulation:

> As in *Lloyd Noland*, in promulgating the final extinguishment proceeds regulation, Treasury failed to respond to the relevant and significant comment from NYLC as to the post-donation improvements issue. In the proposed regulations' preamble, Treasury stated that the "regulations reflect the major policy decisions made by the Congress and expressed in the[ ] committee reports" to the Tax Treatment Extension Act of 1980. 48 Fed. Reg. at 22,940. One of the policy decisions reflected in those "committee reports," expressly referenced by Treasury, provided that "the preservation of our country's natural resources and cultural heritage is important," that "conservation easements now play an important role in preservation efforts," and that "provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures." S. Rep. No. 96-1007, at 9 (1980). NYLC's comment recognized as much, stating that "[t]he statute was enacted by Congress to encourage the protection of our significant natural and built environment through the donation of conservation restrictions."
>
> As to the proposed regulation overall, NYLC stated that the proposed regulation "would thwart the purpose of the statute by deterring prospective donors" concerned about tying themselves to share proceeds of a sale with the donee "under circumstances which cannot possibly be foreseen." Additionally, NYLC specifically commented that the regulation's proceeds formula: (1) "contemplates that a ratio of value of the conservation restriction to value of the fee will be fixed at the time of the donation and will remain in effect forever thereafter"; and (2) "fail[ed] to take into account that improvements may be made thereafter by the owner which should properly alter the ratio." And NYLC warned that this outcome "would obviously be undesirable to the prospective donor and would constitute a windfall to the donee organization" and "strongly recommend[ed] deletion of the entire extinguishment provision," or at least revised "to prevent such inequities." In other words, NYLC challenged a fundamental premise underlying Treasury's proposed regulations by "in effect counter[ing] that the proposed rule on future donor improvements was contrary to those policy decisions [mentioned in the proposed regulations], would lead to inequitable results that were inconsistent with the statute, and would deter future contributions." See *Oakbrook*, 154 T.C. at 225 (Toro, J., concurring).
>
> Simply put, NYLC's comment was significant and required a response by Treasury to satisfy the APA's procedural requirements. And the fact that Treasury stated that it had considered "all comments," without

> more discussion, does not change our analysis, as it does not "enable [us] to see [NYLC's] objections and why [Treasury] reacted to them as it did." *Lloyd Noland*, 762 F.2d at 1566.[9]

Thus, the opinion concludes:

> Because Treasury, in promulgating the extinguishment proceeds regulation, failed to respond to NYLC's significant comment concerning the post-donation improvements issue as to proceeds, it violated the APA's procedural requirements. See *Lloyd Noland*, 762 F.2d at 1566; see also *Oakbrook*, 154 T.C. at 225–27 (Toro, J., concurring). We thus conclude that the Commissioner's interpretation of § 1.170A-14(g)(6)(ii), to disallow the subtraction of the value of post-donation improvements to the easement property in the extinguishment proceeds allocated to the done, is arbitrary and capricious and therefore invalid under the APA's procedural requirements. Accordingly, we reverse the Tax Court's order disallowing the Hewitts' carryover charitable deductions as to the donation of the conservation easement and remand for further proceedings.[10]

Advisers must take care to note that the decision, at least for now, only impacts taxpayers whose appeals would be heard by the Eleventh Circuit Court of Appeals which covers the states of Alabama, Florida and Georgia.[11] Outside of that Circuit, the Tax Court would be expected to continue to follow its own published opinion in *Oakbrook Land Holdings, LLC v. Commissioner*, 154 T.C. 180 (2020) which upheld the validity of the regulation until and unless the Tax Court decides to abandon reliance on that ruling.

Advisers should watch to see if this same issue is brought before other Circuit Courts of Appeal and how those Circuits rule or, in what is a far less likely development, the IRS decides to appeal this case to the U.S. Supreme Court and that Court decides to hear this matter. Normally the Supreme Court only hears cases like this if there is a clear conflict in the decisions of different Circuit Courts of Appeal on the issue.

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[9] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), December 29, 2021

[10] *Hewitt v. Commissioner*, Case No. 20-13700, (2021 CA11), December 29, 2021

[11] *Golsen v. Commissioner*, 54 TC 742 (1970)

SECTION: 2702
VALUATION SHOULD HAVE INCLUDED CONSIDERATION OF LIKELY SALE OF BUSINESS

Citation: CCA 202152018, 12/30/21

Determining the fair market value for a closely-held business for various tax purposes depends upon valuations assuming a willing buyer and willing seller aware of all relevant facts. In CCA 202152018[12] the IRS finds that the valuation used by a taxpayer in attempting to set up a grantor retained annuity trust (GRAT) did not consider the fact that there was a high likelihood the entity being valued would be likely involved in a lucrative merger in the near future.

IRC §2702 governs the values of certain interests transferred in trust:

> Solely for purposes of determining whether a transfer of an interest in trust to (or for the benefit of) a member of the transferor's family is a gift (and the value of such transfer), the value of any interest in such trust retained by the transferor or any applicable family member (as defined in section 2701(e)(2)) shall be determined as provided in paragraph (2).[13]

Under IRC §2702(a)(2)(A), the value of any interest retained by the donor in a trust is set at zero. Thus, the entire value will be deemed as being transferred to the remainder interest holders, so if $1,000,000 of assets are put in trust for a member of the donor's family as the remainder beneficiary and the donor retains an interest that would normally be valued at $500,000, the value of the beneficiary's interest would be the full $1,000,000 for gift tax purposes and not the $500,000 that represents the economic value of that interest.

The law does provide an option where the donor's interest will not be considered to have a zero value, found at IRC §2702(a)(2)(B), where a *qualified interest* will be valued under IRC §7520 (the IRS valuation tables). This is a GRAT. To be a *qualified interest*, the following three conditions must be met:

- Any interest which consists of the right to receive fixed amounts payable not less frequently than annually,
- Any interest which consists of the right to receive amounts which are payable not less frequently than annually and are a fixed percentage of the fair market value of the property in the trust (determined annually), and

[12] CCA 202152018, December 30, 2021, https://www.taxnotes.com/research/federal/irs-private-rulings/legal-memorandums/anticipated-merger-affects-grat-appraisal-valuation/7cr6d (retrieved December 31, 2021)
[13] IRC §2702(a)

- Any noncontingent remainder interest if all of the other interests in the trust consist of interests described in the prior two bullets.[14]

If an interest does not strictly meet the requirements above, then its value will be set to zero under the default treatment of IRC §2702(a)(2)(A). In this case the question will be whether the annuity payment was actually being determined based on the fair market value of the property in the trust.

The memorandum begins by discussing the donor's commencement of an attempt to find an outside buyer for his very successful company:

> Donor is the founder of a very successful company, Company. At the end of Year 1, Donor contacted two Investment Advisors to explore the possibility of finding an outside buyer. The facts indicate that, "[T]he Company was marketed through outreach by investment bankers to potential strategic buyers, some of which had previously expressed an interest in partnering with [Company]. Meetings were then scheduled to introduce [Company] and determine if there was additional interest." Potential buyers were expected to purchase a minority stake of Company with a call option after several years to acquire the remainder of Company at a formula valuation.
>
> In Year 2, approximately six months later and within a two-week period concluding on Date 1, the Investment Advisors presented Donor with an offer from each of Corporation A, Corporation B, Corporation C, Corporation D, and Corporation E (collectively, the Corporations).[15]

At this point, the Donor made a transfer to a trust that was intended to qualify as a GRAT under IRC §2702:

> Three days later, on Date 2, Donor created Trust, a two-year grantor retained annuity trust (GRAT), the terms of which appeared to satisfy the requirements for a qualified interest under § 2702 and the corresponding regulations. Under the terms of Trust, the trustee was to base the amount of the annuity payment on a fixed percentage of the initial fair market value of the trust property. Donor funded Trust with a shares of Company. The value of the shares of Company was determined based on an appraisal of Company on December 31, Year 1, a date approximately seven months prior to the transfer to Trust. The appraisal, which was obtained in order to satisfy the reporting

[14] IRC §2702(b)

[15] CCA 202152018, December 30, 2021

> requirements for nonqualified deferred compensation plans under § 409A of the Code, valued the shares of Company at $w per share.[16]

Note the use here of a valuation that was performed just after the Donor began having advisers contact third parties to determine interest in the Company, but well before the Donor had five offers to buy on the table. As well, the purpose of that valuation was for reporting for the IRC §409A plans.

The process of completing a merger then moved forward.

> Additional time was granted to the Corporations to submit final offers. The last offer was received on Date 3, almost three months after the initial offers. Corporations A through D raised their offers, while Corporation E withdrew from the bidding, expressing no further interest.[17]

Now the Donor establishes and funds a charitable remainder trust (CRT), this time obtaining a new valuation for this purpose:

> On Date 4, Donor gifted Company shares to a separate charitable remainder trust and valued those shares at $x per share pursuant to a qualified appraisal. This per share value was equal to the tender offer value described below.[18]

Following the formation of the CRT, the sale process continued and concluded:

> Three months after the new offers were received and several weeks after the transfer to his charitable remainder trust, Donor accepted Corporation A's offer, which represented a 10 percent increase over its initial offer. Per the final offer, an initial cash tender offer was made of $x per share, an amount that was nearly three times greater than $w (the value determined as of December 31, Year 1). During the tender period, Donor tendered b shares, while Donor's charitable remainder trust also took advantage of the tender offer.
>
> On December 31, Year 2, Donor again had Company appraised for purposes of § 409A and the new appraised value was $y per share, which was almost twice the previous year's value of $w per share.2 These steps were repeated for a December 31, Year 3 appraisal with similar results. The December 31, Year 2 and Year 3 appraisals both included the following language: "[a]ccording to management, there have been no other recent offers or closed transactions in Company

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[16] CCA 202152018, December 30, 2021

[17] CCA 202152018, December 30, 2021

[18] CCA 202152018, December 30, 2021

> shares as of the Valuation Date." There was no such declaration in the December 31, Year 1 appraisal.
>
> In Year 4, approximately six months after the end of Trust's two-year GRAT term, Corporation A purchased the balance of the Company shares for $z per share, a price almost double the value of $y.[19]

The CCA notes that while, generally, events occurring after the date of a donation are not considered as of the valuation date, what was known about such events, including how likely the events are to take place, do have an impact:

> Generally, a valuation of property for Federal transfer tax purposes is made as of the valuation date without regard to events happening after that date. *Ithaca Trust Co. v. United States,* 279 U.S. 151 (1929). Subsequent events may be considered, however, if they are relevant to the question of value. *Estate of Noble v. Commissioner*, T.C. Memo. 2005-2 n.3. Federal law favors the admission of probative evidence, and the test of relevancy under the Federal Rules of Evidence is designed to achieve that end. *Id*. Thus, a post-valuation date event may be considered if the event was reasonably foreseeable as of the valuation date. *Trust Services of America, Inc. v. U.S.*, 885 F.2d 561, 569 (9th Cir. 1989); *Bank One Corp.*, 120 T.C. 174, 306. [20]

But even if the event is not reasonably foreseeable, a sale shortly after the event in a sale where we have truly willing buyers and sellers does provide evidence of value.

> Furthermore, a post-valuation date event, even if unforeseeable as of the valuation date, also may be probative of the earlier valuation to the extent that it is relevant to establishing the amount that a hypothetical willing buyer would have paid a hypothetical willing seller for the subject property as of the valuation date. See *Estate of Gilford v. Commissioner*, 88 T.C. 38, 52-55 (1987).[21]

If a taxpayer or the IRS wants to ignore that sale, generally the party pushing to ignore that value will want to explain what changed that renders this later arms-length sale not representative of the value at the date the value is important from a tax perspective.

The key issue is what information would have been available to the willing buyer and willing seller at the date in question, as the memorandum discusses:

> The principle that the hypothetical willing buyer and willing seller are presumed to have "reasonable knowledge of relevant facts" affecting

[19] CCA 202152018, December 30, 2021

[20] CCA 202152018, December 30, 2021

[21] CCA 202152018, December 30, 2021

> the value of property at issue applies even if the relevant facts at issue were unknown to the actual owner of the property. *Estate of Kollsman v. Commissioner*, T.C. Memo. 2017-40, *aff'd*, 777 Fed. Appx. 870 (9th Cir. 2019). In addition, both parties are presumed to have made a reasonable investigation of the relevant facts. *Id*. Thus, in addition to facts that are publicly available, reasonable knowledge includes those facts that a reasonable buyer or seller would uncover during negotiations over the purchase price of the property. *Id*. Moreover, a hypothetical willing buyer is presumed to be "reasonably informed" and "prudent" and to have asked the hypothetical willing seller for information that is not publicly available. *Id*.[22]

The CCA outlines the taxpayers' explanation for the use of the seven month old valuation for the GRAT contribution and annuity amount and the use of a new valuation for the CRT funding shortly thereafter:

> When asked to explain the use of the outdated appraisal (as of December 31, Year 1) to value the transfer to the GRAT, as well as the use of a new appraisal to value the transfers to charity, the company that conducted the appraisal stated only that "[t]he appraisal used for the GRAT transfer was only six months old, and business operations had not materially changed during the 6-month period . . . For the charitable gifts, under the rules for Form 8283, in order to substantiate a charitable deduction greater than $5,000, a qualified appraisal must be completed. Because of this requirement an appraisal was completed for the donations of [Company] stock to various charities on [Date 4]."[23]

In analyzing this situation, the CCA finds one court case especially helpful. The CCA discusses the facts and rulings in the *Ferguson* case:

> In *Ferguson v. Commissioner*, 174 F.3d 997 (9th Cir. 1999), *aff'g* 108 T.C. 244 (1997), the appellate court considered the issue of whether the Tax Court correctly held that taxpayers were liable for gain in appreciated stock under the anticipatory assignment of income doctrine. In *Ferguson*, taxpayers owned 18 percent of AHC and served as officers and on the board of directors. In late 1987 and early 1988, the AHC board of directors contacted and eventually authorized Goldman, Sachs & Co. to find a purchaser of AHC and to assist in the negotiations. By July 1988, Goldman, Sachs had found four prospective purchasers. Shortly thereafter, AHC entered into a merger agreement with DCI Holdings, Inc. With the taxpayers abstaining from the vote, the AHC board unanimously approved the merger

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[22] CCA 202152018, December 30, 2021

[23] CCA 202152018, December 30, 2021

> agreement. On August 3, 1988, the tender offer was started. On August 15, the taxpayers, with the help of their broker, executed a donation-in-kind record with respect to their intention to donate stock to a charity and two foundations. On September 9, 1988, the charity and the foundations tendered their stock. On September 12, 1988, the final shares were tendered and on or about October 14, 1988, the merger was completed.
>
> The Court of Appeals affirmed the Tax Court's conclusion that the transfers to charity and the foundations occurred after the shares in AHC had ripened from an interest in a viable corporation into a fixed right to receive cash and the merger was "practically certain" to go through. In particular, the 9th Circuit noted that "[t]he Tax Court really only needed to ascertain that as of [the valuation] date, the surrounding circumstances were sufficient to indicate that the tender offer and the merger were practically certain to proceed by the time of their actual deadlines — several days in the future." *Ferguson*, 174 F.3d at 1004. Consequently, the assignment of income doctrine applied and the taxpayers realized gain when the shares were disposed of by the charity and foundations.[24]

The memorandum finds that this situation was very similar to the *Ferguson* situation:

> The current case shares many factual similarities with *Ferguson, supra*, for example, the targeted search by Donor to find merger candidates, the exclusive negotiations with Corporation A immediately before the final agreement, the generous terms of the merger, and an agreement that was "practically certain" to go through. While the Ferguson opinion deals exclusively with the assignment of income doctrine, it also relies upon the proposition that the facts and circumstances surrounding a transaction are relevant to the determination that a merger is likely to go through. See *Bank One* and *Kollsman*, *supra*.
>
> Further, the current case presents an analogous issue, that is, whether the fair market value of the stock should take into consideration the likelihood of the merger as of the date of the transfer of the shares to Trust. The *Ferguson* and *Silverman* opinions, as considered by the Tax Court and the Ninth Circuit and Second Courts of Appeal, respectively, support the conclusion that the value of the stock in Company must take into consideration the pending merger. Accordingly, the value determined in the December 31, Year 1 appraisal does not represent the fair market value of the shares as of the valuation date. Under the fair market value standard as articulated in § 25.2512-1, the hypothetical willing buyer and willing seller, as of Date

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[24] CCA 202152018, December 30, 2021

> 2, would be reasonably informed during the course of negotiations over the purchase and sale of the shares and would have knowledge of all relevant facts, including the pending merger. Indeed, to ignore the facts and circumstances of the pending merger undermines the basic tenets of fair market value and yields a baseless valuation, and thereby casts more than just doubt upon the bona fides of the transfer to the GRAT.[25]

The memorandum goes on to find that this dooms the entire GRAT structure:

> In addition, although the governing instrument of Trust appears to meet the requirements in § 2702 and the corresponding regulations, intentionally basing the fixed amount required by § 2702(b)(1) and § 25.2702-3(b)(1)(i) on an undervalued appraisal causes the retained interest to fail to function exclusively as a qualified interest from the creation of the trust. The trustee's failure to satisfy the "fixed amount" requirement under § 2702 and § 25.2702-3(b)(1)(ii)(B) is an operational failure because the trustee paid an amount that had no relation to the initial fair market value of the property transferred to the trust; instead, the amount was based on an outdated and misleading appraisal of Company, at a time when Company had received offers in the multi-billion dollar range. When asked about the use of the outdated appraisal, the company that conducted the appraisal stated only that business operations had not materially changed during the 6-month period. In contrast, in valuing the transfer to the charitable trust, the company that conducted the appraisal focused only on the tender offer, and accordingly gave little weight to the business operations for valuation purposes.
>
> The operational effect of deliberately using an undervalued appraisal is to artificially depress the required annual annuity. Thus, in the present case, the artificial annuity to be paid was less than 34 cents on the dollar instead of the required amount, allowing the trustee to hold back tens of millions of dollars. The cascading effect produced a windfall to the remaindermen. Accordingly, because of this operational failure, Donor did not retain a qualified annuity interest under § 2702. See *Atkinson*.[26]

Of course, this document is merely a memorandum from the IRS Chief Counsel's office, and there's no guarantee that a court would agree with the entirety of this analysis or find any shortcomings are totally fatal to the GRAT.

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[25] CCA 202152018, December 30, 2021

[26] CCA 202152018, December 30, 2021

But certainly, it appears the facts of this case present the IRS with opportunities it would have been better had the taxpayer avoided. While it's very likely the IRS would have complained about using the valuation from the prior December for the GRAT regardless, the creation of the CRT triggered a significantly higher valuation that was much closer in time to the funding of the GRAT. The higher valuation conceded that, at least by the date of the CRT funding, the taxpayer's position was that the merger negotiations greatly increased the fair market value of the operation.

Certainly, the taxpayer and advisers should have recognized that using the appraisal prepared months earlier to value the contribution to the GRAT was going to lead to questions in the event of an IRS challenge due to events related to the eventual sale that took place between the date of the valuation and the date the GRAT was funded. A preparation of a valuation at the GRAT funding date and basing the annuity payments on that amount would have greatly reduced this risk.

Similarly, when it was decided to fund a charitable remainder trust, the fact that a new, much higher appraisal would be prepared should have raised concerns about both the risk and potential for success of an IRS attack against the GRAT which relied upon a much older valuation before the merger talks got serious.

Obviously, we are not privy to how the taxpayer and advisers addressed these issues, or what facts they may believe would serve to blunt the impact of the IRS's arguments since this is purely an IRS document. But the memorandum should serve to remind advisers of the need to consider issues that arise when the taxpayer decides against getting an updated valuation prepared before any major gift tax or income tax transaction.

At the very least, a valuation prepared as of the date of the transaction allows the appraiser to outline the facts being relied upon as well as a justification at the time regarding any arguments to limit the impact of such negotiations in process. While clients may balk at paying for "yet another" valuation, a valuation prepared right at the time of a gift transaction before the final results of negotiations to sell the business are known will be a lot easier to defend than an attempt to argue, after all parties know what ultimately happened, that that result was not easy to spot at the valuation date.

SECTION: 6603
AMOUNTS PAID AFTER TAX ASSESSED WERE NOT A DEPOSIT, TAXPAYER'S CASE BEFORE THE TAX COURT RENDERED MOOT

Citation: Ahmed v. Commissioner, TC Memo 2021-142, 12/28/21

The Tax Court ruled that a taxpayer's attempt to make a deposit rather than a payment of taxes failed when the tax had been assessed prior to the date the attempted deposit was made in the case of *Ahmed v. Commissioner*, TC Memo 2021-142.[27]

Deposit Rules

IRC §6603, enacted in 2004, allowed taxpayers to, in specific cases, make deposits with the IRS to stop the running of interest on an underpayment the IRS may assess in the future. IRC §6603(a) provides:

> (a) Authority to make deposits other than as payment of tax
>
> A taxpayer may make a cash deposit with the Secretary which may be used by the Secretary to pay any tax imposed under subtitle A or B or chapter 41, 42, 43, or 44 which has not been assessed at the time of the deposit. Such a deposit shall be made in such manner as the Secretary shall prescribe.

Under IRC §6603(b) any amount of the deposit actually used to pay tax will be treated as paid on the date the deposit was made. As well, under IRC §6603(c) if the taxpayer requests in writing that a deposit be returned to the taxpayer while it remains a deposit, the IRS is to return such funds unless the IRS determines that collection of the tax is in jeopardy.

Attempt at Making a Deposit Under IRC §6603

In this case, the taxpayer was disputing the IRS's position that he was liable for trust fund recovery penalties (TFRP) under IRC §6672 in a collection review case that had

[27] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/individual%e2%80%99s-challenge-to-lien-is-moot%2c-tax-court-says/7cqzr (retrieved December 29, 2021)

made its way before the Tax Court. The Tax Court describes the situation that resulted in the payment of $625,000 the taxpayer wished to have treated as a deposit:

> On May 1, 2020, a supplemental Appeals conference was held by telephone. On or around June 9, 2020, petitioner sent to the IRS a check for $625,000 along with a letter, dated June 9, 2020, and signed by petitioner's counsel (June 9, 2020, letter). This letter stated that the $625,000 remittance "constitutes a cash bond deposit" for petitioner's TFRP liabilities for his tax periods ending March 31, June 30, and September 30, 2016, and indicated that the aggregate balance due for these liabilities was $617,039 (the sum of $80,737, $411,038 and $125,264 for the quarters ending March 31, June 30, and September 30, 2016, respectively).[28]

The letter that was sent along with the payment contained the following language, in part:

> Under Internal Revenue Code § 6603 and under Rev. Proc. 2005-18, we designate this remittance as a deposit in the nature of a cash bond for the TFRP liabilities of Faisal Ahmed, for the tax periods stated in the above table [the tax periods ending March 31, June 30, and September 30, 2016].
>
> This remittance is a deposit and not a payment of tax within the meaning of Rev. Proc. 2005-18 and should not be posted as a final payment to Taxpayer's account until a decision in the United States Tax Court has been entered.
>
> This cash bond is eligible for interest under IRC § 6603(d). * * *
>
> * * * * * * *
>
> To the extent the remittance is more than the amount owed, we designate the remaining funds to be applied to the Taxpayer's 2017 income tax liability (Form 1040). This remittance is a deposit and not a payment of tax within the meaning of Rev. Proc. 2005-18 and should not be posted as a final payment to Taxpayer's account until decision has been entered in the United States Tax Court.
>
> If any excess remains after this remittance is posted as payment of assessed tax and/or interest for this taxable year in accordance with the subsequent designation, such excess should be immediately refunded to Faisal Ahmed * * * with interest under § 6603(d).[29]

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[28] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

[29] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

Despite these statements in the letter, the IRS went ahead and applied the funds to the outstanding TFRP that had already been assessed prior to the payment of the funds (remember, we are in a collection matter at this point).

> On June 29, 2020, the IRS posted petitioner's $625,000 remittance as payment towards petitioner's outstanding TFRP liabilities for the periods stated in the June 9, 2020, letter, resulting (in combination with some payments that petitioner had previously made) in the full payment of petitioner's TFRP liabilities for the quarters ending March 31, June 30, September 30, and December 31, 2016.3 On September 25, 2020, respondent released the Federal tax lien with respect to the periods at issue. Appeals has not issued any supplemental notice of determination regarding the supplemental hearing held May 1, 2020.[30]

And the IRS argues this makes the collection matter moot, thus the taxpayer can no longer contest the matter in the Tax Court as the liabilities have been fully paid:

> Respondent's motion asserts that petitioner has fully paid his TFRP liabilities for the quarters ending March 31, June 30, September 30, and December 31, 2016. Accordingly, respondent asserts, he does not need or intend to take any further collection action with respect to those periods and has released the lien against petitioner. Consequently, respondent argues, there is no remaining case or controversy to sustain this Court's jurisdiction with respect to petitioner's TFRP liabilities and this case, being no longer justiciable, should be dismissed on grounds of mootness.[31]

Not surprisingly, the taxpayer disagrees with this view:

> In his objection to respondent's motion, petitioner argues that (1) the liabilities at issue should not be deemed fully paid because his $625,000 remittance should have been treated as a deposit rather than payment of tax and (2) this purported deposit does not extinguish petitioner's challenges to the validity of respondent's assessment, respondent's calculation of interest, or the appropriateness of respondent's releasing the lien as opposed to withdrawing the NFTL, and does not relieve respondent from his obligation to comply with the Court's order dated March 5, 2020.[32]

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[30] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

[31] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

[32] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

Was the Taxpayer's Collection Action Moot?

The Tax Court notes that there are limits on the cases it is allowed to hear. With regard to collection matters, the opinion notes:

> Section 6330(d)(1) provides that this Court has jurisdiction to review an Appeals determination. However, the Tax Court is a court of limited jurisdiction, sec. 7442, and we may exercise jurisdiction only to the extent expressly authorized by Congress, *Naftel v. Commissioner*, 85 T.C. 527, 529 (1985). In general, our jurisdiction under section 6330(d)(1) is limited to reviewing whether the Commissioner's proposed collection activity is appropriate. *Greene-Thapedi v. Commissioner*, 126 T.C. 1, 7 (2006). Ordinarily, once the Commissioner concedes that there is no unpaid liability for a disputed year upon which a collection action could be based, a proceeding filed in this Court pursuant to section 6330 is moot. *Id.*; *MacDonald v. Commissioner*, T.C. Memo. 2009-240, 2009 Tax Ct. Memo LEXIS 242, at *7 ("[A] case filed pursuant to section 6330 is moot if the Federal income tax liability that the Commissioner is attempting to collect has been paid in full so that no collection action is appropriate."). Section 6330 does not give the Court jurisdiction to determine an overpayment or order a refund or credit of taxes paid. *Willson v. Commissioner*, 805 F.3d 316 (D.C. Cir. 2015); *Greene-Thapedi v. Commissioner*, 126 T.C. at 7-8.[33]

Effectively, if there is no tax left to be collected, then the Tax Court has no matter upon which to rule in a post-assessment collection case.

The taxpayer argues that as the amount paid was labeled a deposit, it did not amount to having paid the tax and, thereby, did not moot any collection issue the Tax Court could rule upon:

> Petitioner does not expressly dispute that full payment of his tax liabilities would moot this collection action. He contends, however, that his $625,000 remittance was not a payment but rather "a deposit to secure the discharge of the lien". Accordingly, he suggests, the remittance did not moot this action.[34]

But the Tax Court did not accept the taxpayer's view on this one. The opinion first notes that even before this attempted deposit, the taxpayer had already paid off the

[33] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

[34] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

TFRP for one quarter, so even if the Court were to find the deposit was not a payment of the tax, that quarter's TRFP was no longer before the Tax Court.[35]

But the Court goes on to reject the taxpayers' arguments for the remaining three quarters as well. First, the Court notes that the taxpayer had conceded the payments could not qualify as a deposit under IRC §6603. In a footnote the Court pointed out two separate reasons why this payment could not be a deposit:

> Sec. 6603(a), as enacted in 2004, provides that a taxpayer may make a cash deposit with respect to "any tax imposed under subtitle A or B or chapter 41, 42, 43, or 44 which has not been assessed at the time of the deposit." Respondent asserts that petitioner's $625,000 remittance failed to qualify as a deposit under sec. 6603(a) because petitioner's TFRP liabilities had already been assessed at the time of the remittance. Seemingly on this basis petitioner concedes the nonapplicability of sec. 6603. Neither party has addressed what would seem to be a more fundamental impediment to treating the remittance as a deposit under sec. 6603(a), namely that TFRP liabilities are imposed under sec. 6672, which is in chapter 68 in subtitle F of the Code, rather than in any of the subtitles or chapters listed in sec. 6603(a).[36]

However, the taxpayer argues that there exists an older judicially created rule he can qualify under:

> He argues, however, that it nevertheless constitutes a deposit under a judicially created "facts and circumstances approach" that predates the enactment of section 6603. In support of this proposition petitioner cites *Rosenman v. United States*, 323 U.S. 658 (1945), and *Deaton v. Commissioner*, T.C. Memo. 2005-1, *aff'd*, 440 F.3d 223 (5th Cir. 2006).[37]

The Tax Court found there was an important difference in those cases—in neither case had the tax been assessed before the funds were sent to the IRS.

> These cases, however, are readily distinguishable from the case at hand. Each case involved remittances that — unlike petitioner's $625,000 remittance — were made before the taxpayers' tax liabilities had been assessed. Because petitioner's TFRP liabilities had been assessed before he made his $625,000 remittance, it constituted payment of those liabilities. See *Charles Leich & Co. v. United States*, 329 F.2d 649, 652 (Ct. Cl. 1964) ("It seems clear that a remittance made by a taxpayer of

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[35] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

[36] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

[37] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

> an amount * * * given in response to an assessment of taxes by the Internal Revenue [*10] Service is a payment of tax."). In any event, even if we were to agree with petitioner that his $625,000 remittance constituted a deposit in the first instance (which we do not), respondent's application of the remittance as payment towards petitioner's assessed and outstanding TFRP liabilities would have constituted payment of those liabilities. See *Rosenman*, 323 U.S. at 661 (holding that the Government's application of a remittance after the taxpayer's deficiency had been assessed constituted payment of the tax liability, triggering the limitations period for the taxpayer to claim a refund).[38]

The Court concludes that with no unpaid liability remaining, the Tax Court lacks jurisdiction:

> In sum, no unpaid liability remains on petitioner's tax accounts for the periods with respect to which the NFTL was filed. Respondent has released the lien and there is no outstanding tax liability on which further collection action could be based. Petitioner has received all the relief that section 6330 authorizes the Tax Court to provide.[39]

The opinion concludes by noting that any further litigation would need to be in front of a different court:

> If petitioner seeks a refund or overpayment credit or other relief, then any legal remedy would lie in a U.S. District Court or the U.S. Court of Federal Claims rather than in this Court.[40]

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[38] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

[39] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

[40] *Ahmed v. Commissioner*, TC Memo 2021-142, December 28, 2021

SECTION: CARES

IRS REMINDS EMPLOYERS AND SELF-EMPLOYED INDIVIDUALS OF RAPIDLY APPROACHING TAX DEFERRAL PAYMENT DEADLINE

Citation: "IRS reminder: For many employers and self-employed people, deferred Social Security tax payment due Jan. 3," IRS News Release IR-2021-256, 12/27/21

The IRS in News Release IR-2021-256 reminded taxpayers who deferred paying employer FICA for a portion of 2020 or a portion of their 2020 self-employment tax that a deadline is approaching on January 3 to pay a portion of the deferred taxes.[41]

The release explains the option provided to qualified taxpayers in 2020:

> As part of the COVID relief provided during 2020, employers and self-employed people could choose to put off paying the employer's share of their eligible Social Security tax liability, normally 6.2% of wages. Half of that deferral is now due on January 3, 2022, and the other half on January 3, 2023.[42]

The release notes that affected taxpayers should have received a reminder billing notice from the IRS recently:

> Most affected employers and self-employed individuals received reminder billing notices from the IRS.[43]

But the IRS warns that claiming the taxpayer did not receive a billing will not excuse the taxpayer from the consequences of not timely paying the amount due:

> The agency noted, however, that those affected are still required to make the payment on time, even if they did not receive a bill.[44]

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[41] "IRS reminder: For many employers and self-employed people, deferred Social Security tax payment due Jan. 3," IRS News Release IR-2021-256, December 27, 2021, https://www.irs.gov/newsroom/irs-reminder-for-many-employers-and-self-employed-people-deferred-social-security-tax-payment-due-jan-3 (retrieved December 27, 2021)

[42] "IRS reminder: For many employers and self-employed people, deferred Social Security tax payment due Jan. 3," IRS News Release IR-2021-256, December 27, 2021

[43] "IRS reminder: For many employers and self-employed people, deferred Social Security tax payment due Jan. 3," IRS News Release IR-2021-256, December 27, 2021

[44] "IRS reminder: For many employers and self-employed people, deferred Social Security tax payment due Jan. 3," IRS News Release IR-2021-256, December 27, 2021

The Notice provides the following instructions on how taxpayers should pay the amounts due:

> Employers and individuals can make the deferral payments through the Electronic Federal Tax Payment System or by credit or debit card, money order or with a check. To be sure these payments are credited properly, they must be made separately from other tax payments.
>
> EFTPS has an option to make a deferral payment. On the Tax Type Selection screen, choose Deferred Social Security Tax and then change the date to the applicable tax period (typically, the calendar quarter in 2020 for which tax was deferred). Visit EFTPS.gov, or call 800-555-4477 or 800-733-4829 for details.
>
> Individual taxpayers can also use Direct Pay, available only on IRS.gov. Select the "balance due" reason for payment. If paying with a debit or credit card, select "installment agreement." Apply the payment to the 2020 tax year where the payment was deferred.[45]

A link in the News Release directs taxpayers to https://www.irs.gov/payments for links to the various payment options that can be used.[46]

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[45] "IRS reminder: For many employers and self-employed people, deferred Social Security tax payment due Jan. 3," IRS News Release IR-2021-256, December 27, 2021

[46] "IRS reminder: For many employers and self-employed people, deferred Social Security tax payment due Jan. 3," IRS News Release IR-2021-256, December 27, 2021