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by Hale E. Sheppard

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Conservation Easements, Partners, and Qualified Amended Returns?

by Hale E. Sheppard

Hale E. Sheppard is a shareholder in the tax controversy and litigation section and chair of the international tax section of Chamberlain Hrdlicka White Williams & Aughtry in Atlanta.

In this article, Sheppard highlights the need for clarity from the IRS about filing qualified amended returns in the context of syndicated conservation easement transactions.

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I. Introduction

The IRS is sending mixed messages when it comes to potential resolution of disputes involving partnerships that engaged in a so-called syndicated conservation easement transaction (SCET). On one hand, the IRS has taken several enforcement actions recently, which make it procedurally impossible for an individual partner to voluntarily resolve matters with the IRS and remain penalty-free by submitting a qualified amended return (QAR). On the other hand, the IRS commissioner issued two news releases in November and December, warning taxpayers of increased enforcement activities and "encouraging" them to file QARs.

This apparent inconsistency has many in the tax community confused and unable to properly advise partners, partnerships, and others. The good news is that the regulations seem to grant the commissioner authority to modify the QAR rules as necessary. This article reviews SCET issues; explains ongoing enforcement tools; summarizes recent IRS announcements urging taxpayers to file QARs; describes the stringent QAR standards; and identifies the issues for which the tax community is seeking clarification from the IRS.

II. Overview of Conservation Easement Issues

A. What Is a Qualified Contribution?

Taxpayers generally may deduct the value of any charitable contributions they make during a year.[1] However, the taxpayer is not entitled to claim a tax deduction if the donation consists of less than the entire interest of the taxpayer in the relevant property.[2] One important exception is that a taxpayer can deduct a donation of a partial interest in property (instead of an entire interest) if that interest constitutes a "qualified conservation contribution."[3] To meet this critical definition, a taxpayer must show that it is donating (1) a qualified real property interest (QRPI) (2) to a qualified organization, which is normally a land trust; or (3) exclusively for conservation purposes.[4]

B. What Is a QRPI?

A QRPI can be one of several things, including a restriction, granted in perpetuity, on the use of a specific piece of real property.[5] This is known by many names, among them conservation easement and conservation restriction.[6] Regardless of what you call them, QRPIs must be based on legally enforceable restrictions, memorialized in a deed of conservation easement filed with the proper court or other location, preventing uses of the

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[1] Section 170(a)(1); reg. section 1.170A-1(a).

[2] Section 170(f)(3)(A); reg. section 1.170A-7(a)(1).

[3] Section 170(f)(3)(B)(iii); reg. section 1.170A-7(a)(5).

[4] Section 170(h)(1).

[5] Section 170(h)(2); reg. section 1.170A-14(a); reg. section 1.170A-14(b)(2).

[6] Reg. section 1.170A-14(b)(2).

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property that are inconsistent with the conservation purposes.[7]

C. For What Purposes Can Land Be Conserved?

A donation has a conservation purpose if it meets one of the following requirements: (1) it preserves land for outdoor recreation by, or the education of, the public; (2) it preserves a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem; (3) it preserves open space (including farmland and forest land) for the scenic enjoyment of the public and will yield a significant public benefit; (4) it preserves open space (including farmland and forest land) under a federal, state, or local governmental conservation policy and will yield a significant public benefit; or (5) it preserves a historically important land area or a certified historic structure.[8] The conservation purposes must be protected forever to trigger the tax deduction. Indeed, a donation is not treated as "exclusively for conservation purposes," unless the conservation purposes are "protected in perpetuity."[9]

D. In What Condition Was the Property?

When the donation of a QRPI includes the donor reserving specific rights, the tax deduction will not be allowed unless before the donation is made, the donor makes available to the easement recipient "documentation sufficient to establish the condition of the property at the time of the gift."[10] This is generally called the baseline report. It may (not must) include (1) the appropriate survey maps from the U.S. Geological Survey, showing the property line and other contiguous or nearby protected areas; (2) a map of the area drawn to scale showing all existing man-made improvements or incursions, vegetation and identification of flora and fauna (for example, locations of rare species, animal breeding and roosting areas, and migration routes), land use history, and distinct natural features; (3) an aerial photograph of the property taken as closely as possible to the date of the donation; and (4) photographs taken at appropriate locations on the property.[11]

E. What Is an Easement Worth?

Generally, a deduction for a charitable donation is allowed in the year in which it occurs.[12] If the donation consists of something other than money, the amount normally is the fair market value of the property at the time the taxpayer makes the donation.[13] For these purposes, the term FMV ordinarily means the price on which a willing buyer and willing seller would agree, with neither party being obligated to participate in the transaction, and with both parties having reasonable knowledge of the relevant facts.[14]

The regulations provide special rules for calculating a deduction stemming from the donation of a conservation easement.[15] The IRS provides the following summary and hints about valuation to its personnel in the audit technique guide (ATG). It explains that the best evidence of FMV of an easement is the sale price of easements comparable with the easement in question, but recognizes that, "in most instances, there are no comparable easement sales."[16] Appraisers, therefore, often must use the before-and-after method. The ATG acknowledges that this effectively means that an appraiser must determine the highest and best use (HBU) for the property *and* the corresponding FMV twice. First, the appraiser calculates the FMV with the assumption that the taxpayer would put the property to its HBU, which generates the "before" value. Second, the appraiser identifies the FMV, taking into account the restrictions on the property imposed by the conservation easement, which creates the "after" value.[17] The difference

[7]Reg. section 1.170A-14(g)(1); *Turner v. Commissioner*, 126 T.C. 299, 311 (2006).

[8]Section 170(h)(4)(A); reg. section 170A-14(d)(1); S. Rep. No. 96-1007, at 10 (1980).

[9]Section 170(h)(5)(A); reg. section 1.170A-14(e)(1).

[10]Reg. section 1.170A-14(g)(5)(i).

[11]*Id.*

[12]Section 170(a)(1).

[13]Section 170(a)(1); reg. section 1.170A-1(c)(1).

[14]Reg. section 1.170A-1(c)(2).

[15]Reg. section 1.170A-14(h)(3)(i).

[16]IRS, "Conservation Easement Audit Techniques Guide" (rev. Nov. 4, 2016).

[17]*Id.*

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between the "before" and "after" values, with adjustments, produces the value of the donation.

As indicated in the preceding paragraph, in deciding the FMV of property, appraisers and courts must take into account not only the current use of the property, but also its HBU.[18] A property's HBU is the most profitable use for which it is adaptable and needed, or likely to be needed, in the reasonably near future.[19] The term HBU has also been defined as the reasonably probable use of property that is physically possible, legally permissible, financially feasible, and maximally productive.[20] Importantly, valuation does not depend on whether the taxpayer has actually put the property to its HBU.[21] The HBU can be *any* realistic potential use of the property.[22] Common HBUs are constructing a residential community, creating a mixed-use development, and mining the property.

F. How Do Taxpayers Claim the Tax Deduction?

Properly claiming the tax deduction triggered by an easement donation is complicated. It involves a significant number of actions and documents. The main ones are as follows: The taxpayer must (1) obtain a qualified appraisal from a qualified appraiser; (2) demonstrate that the easement recipient is a qualified organization; (3) obtain a baseline report describing the condition of the property at the time of the donation and the reasons why it is worthy of protection; (4) complete a Form 8283, "Noncash Charitable Contributions," and have it executed by all relevant parties, including the taxpayer, appraiser, and easement recipient; (5) file a timely Form 1065, "U.S. Return of Partnership Income," assuming that the taxpayer is a partnership, enclosing the Form 8283 and qualified appraisal; (6) receive from the easement recipient a proper contemporaneous written acknowledgement, both for the easement itself and for any endowment or stewardship fee donated to finance the perpetual protection of the property; (7) ensure that all mortgages on the relevant property have been satisfied or subordinated to the easement; and (8) send all partners their Schedules K-1 reflecting their allocation of the easement-related deduction, along with a copy of the Form 8283.[23]

III. Actions and Warnings by the IRS

The IRS has been challenging partnerships that engage in SCETs for several years, but it has recently ratcheted up its enforcement efforts.

A. Actions, Old and New

The U.S. government has been attacking partnerships that make easement donations to charitable organizations in various ways. For instance, it has (1) identified them as "listed transactions" in Notice 2017-10, 2017-4 IRB 544; (2) mandated the filing of Form 8886, "Reportable Transaction Disclosure Statement," and Form 8918, "Material Advisor Disclosure Statement," by various parties; (3) launched a compliance campaign that consists of dozens of specialized revenue agents and other IRS personnel; (4) filed a complaint in district court seeking a permanent injunction against specific organizers and appraisers; (5) featured easement transactions on the IRS's "dirty dozen" list; (6) started an inquiry by the Senate Finance Committee on potential abuses; and (7) engaged in a widespread practice of issuing audit reports claiming that easement-related tax deductions should be $0 and imposing severe penalties.

The IRS, through the commissioner, chief counsel, and other high-ranking officials, began intensifying the rhetoric and warnings in November 2019. This messaging has manifested in the form of IRS news releases, public statements at tax conferences, and articles covering the same. The IRS has emphasized that it is (1) pursuing promoters, appraisers, return preparers, material advisers, accommodating entities, charitable organizations, and others; (2)

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[18] *Stanley Works & Subsidiaries v. Commissioner*, 87 T.C. 389, 400 (1986); reg. section 1.170A-14(h)(3)(i) and (ii).

[19] *Olson v. United States*, 292 U.S. 246, 255 (1934).

[20] *Esgar Corp. v. Commissioner*, 744 F.3d 648, 659 n.10 (10th Cir. 2014).

[21] *Id.* at 657.

[22] *Symington v. Commissioner*, 87 T.C. 892, 896 (1986).

[23] *See* IRS, *supra* note 16, at 24-30; IRS Publication 1771, "Charitable Contributions — Substantiation and Disclosure Requirements"; IRS Publication 526, "Charitable Contributions"; section 170(f)(8); section 170(f)(11); reg. section 1.170A-13; Notice 2006-96, 2006-2 C.B. 902; and T.D. 9836.

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making referrals to the Office of Professional Responsibility; (3) raising a long list of technical, procedural, legal, and tax arguments in disputes, while constantly trying to develop more; (4) asserting all possible civil penalties; (5) conducting simultaneous civil examinations and criminal investigations; (6) carrying out separate criminal investigations; and (7) litigating more than 80 cases in Tax Court.[24]

B. Potential Solutions

Despite all these ongoing actions by the IRS, the commissioner has recently encouraged, for lack of a better word, individual partners in partnerships that engaged in SCETs to proactively resolve their issues with the IRS by filing QARs. For instance, in a release disseminated in November, the commissioner stated:

> If you engaged in any questionable [SCET], you should immediately consult an independent, competent tax advisor to consider your best available options. It is always worthwhile *to take advantage of various methods of getting back into compliance by correcting your tax returns before you hear from the IRS*. Our continued use of ever-changing technologies would suggest that waiting is not a viable option for most taxpayers. . . . *Taxpayers may avoid the imposition of penalties relating to improper contribution deductions if they fully remove the improper contribution and related tax benefits from their returns by timely filing a [QAR] or timely administrative adjustment request*.[25] [Emphasis added.]

The commissioner made a similar suggestion to individual partners in a release issued in December. Citing a loss for a partnership just a few days earlier in Tax Court, the commissioner stated:

> If you engaged in any questionable [SCET], you should immediately consult an independent, competent tax advisor to consider your best available options. . . . We encourage taxpayers and their advisors to see the writing on the wall and *take immediate steps to resolve these matters*.[26] [Emphasis added.]

The commissioner's suggestion for taxpayers to file QARs is noteworthy because that might be impossible.

IV. Understanding the QAR

To grasp the issues triggered by the commissioner's recent announcements in the context of SCET enforcement, one must first be familiar with two key tax provisions: sections 6662 and 6664.

A. Relevant Tax Provisions and Regulations

When a tax underpayment is attributable to one of several things, the IRS generally can assert an accuracy-related penalty equal to a percentage of the tax underpayment.[27] The standard penalty is 20 percent of the underpayment amount.[28] However, in some cases, like when the underpayment results from a "gross valuation misstatement," the penalty increases to 40 percent.[29] An important exercise, therefore, is defining an underpayment in this context.

For an individual taxpayer, an underpayment generally means the difference between the tax liability that the taxpayer reported on his Form 1040 and the tax liability that should have been reported, if the taxpayer had completed his Form 1040 correctly.[30] For instance, when the taxpayer's

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[24] IR-2019-182; IR-2019-213; Nathan J. Richman, "Multiple Divisions Coming for Syndicated Conservation Easements," *Tax Notes Federal*, Nov. 18, 2019, p. 1214; William Hoffman, "Conservation Easement Crackdown a Portent, Rettig Says," *Tax Notes Federal*, Nov. 18, 2019, p. 1217; Kristen A. Parillo, "IRS Is Building Up Its Easement Toolbox," *Tax Notes Federal*, Nov. 18, 2019, p. 1215; and Parillo and Hoffman, "IRS Looking for Promoter Links as Easement Crackdown Grows," *Tax Notes Federal*, Dec. 16, 2019, p. 1867.

[25] IR-2019-182.

[26] IR-2019-213. The case referenced by the commissioner was *TOT Property Holdings LLC v. Commissioner*, No. 5600-17 (Dec. 13, 2019). There, the taxpayer claimed an easement-related deduction of $6.9 million on its 2013 Form 1065, and the Tax Court held that the proper deduction was $0 because the deed of conservation easement violated the proceeds-upon-extinguishment regulation, and imposed the highest possible penalty of 40 percent because the deduction was based on a "gross valuation misstatement."

[27] Section 6662(a).

[28] Section 6662 and 6662(b).

[29] Section 6662(h).

[30] Section 6664(a); reg. section 1.6664-2(a). The definition of "underpayment" is considerably more complicated, but a simplified and abbreviated version suffices to make the critical points in this article, without unnecessarily confusing the reader.

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true tax liability was $100,000 but he reported only $80,000 on his Form 1040, the IRS ordinarily could assert a penalty of $4,000 (that is, a $20,000 tax understatement multiplied by 20 percent).[31]

A little-known mechanism exists whereby a taxpayer can reduce or eliminate the tax underpayment after filing the original Form 1040 with the IRS. This is called a QAR. In essence, if a taxpayer files a Form 1040 and later realizes that it resulted in a tax underpayment, he has a limited opportunity to submit a QAR to rectify the situation. The purpose of the original QAR rules was "to encourage voluntary compliance by permitting taxpayers to avoid accuracy-related penalties by filing a [Form 1040X] before the IRS begins an investigation of the taxpayer or the promoter of a transaction in which the taxpayer participated."[32]

According to the regulations, for determining the applicability or size of accuracy-related penalties, the tax liability shown on the original Form 1040 includes the amount of additional tax reflected on the QAR.[33] Modifying the basic example noted above, if the taxpayer filed a Form 1040 showing a tax liability of $80,000 but later submitted a QAR indicating a revised liability of $100,000, no underpayment would exist, and the IRS would thus have no grounds for asserting an accuracy-related penalty. However, it is important to note that the ability to eliminate an underpayment by filing a QAR is unavailable when the position taken on the Form 1040 triggering the underpayment was fraudulent.[34]

B. Sample QAR Statement

Questions often arise about practical aspects of filing a QAR. Put differently, exactly what do individual taxpayers tell the IRS upon filing Form 1040X? To put this into perspective, below is sample language from a statement or attachment to a Form 1040X seeking treatment as a QAR:

This Form 1040X constitutes a QAR, as defined in reg. section 1.6664-2(c)(3), because the Form 1040 to which it relates was not fraudulent, the taxpayer did not participate in an "undisclosed listed transaction," and the taxpayer is filing this Form 1040X *after* the due date for Form 1040 (determined with regard to filing extensions) and *before* (i) the IRS has contacted the taxpayer concerning a civil examination or criminal investigation with respect to Form 1040, (ii) the IRS has contacted any person concerning a promoter examination under section 6700, (iii) the IRS has contacted the pass-through entity concerning a civil examination of the return from which the item(s) in question flowed to the taxpayer's Form 1040, (iv) the IRS has served a summons relating to the tax liability of a person, group, or class that includes the taxpayer with respect to an activity for which the taxpayer claimed any tax benefit on Form 1040, directly or indirectly, and (v) the IRS has announced by revenue ruling, revenue procedure, notice, or announcement to be published in the Internal Revenue Bulletin a settlement initiative to compromise or waive penalties, in whole or in part, with respect to a listed transaction. Reg. section 1.6664-2(c)(2) states that any additional tax shown on a QAR serves to reduce the amount of underpayment on which an accuracy-related penalty may be asserted. In other words, if the taxpayer shows additional taxes owed on a QAR, then such amounts should *not* be subject to accuracy-related penalties under section 6662. Additionally, delinquency penalties under section 6651 would not be applicable because section 6651(a)(2) generally applies to a failure to pay the amount shown as tax on the return on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment), while section 6651(a)(3) generally applies to a failure to pay any amount in respect of any tax required to be shown on the return that

[31] Section 6664(c)(1). Penalties would not apply if the underpayment is attributable to "reasonable cause" and the taxpayer acted in good faith.

[32] T.D. 9186, Preamble, Background.

[33] Reg. section 1.6664-2(c)(2).

[34] *Id.*

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is not so shown within 21 calendar days from the date of notice and demand therefor. Here, the taxpayer timely paid the tax liability showing on Form 1040, such that penalties under section 6651(a)(2) would *not* apply. Moreover, penalties under section 6651(a)(3) would *not* apply because the IRS has not issued (and cannot issue) a notice and demand for payment with respect to the liability shown on Form 1040X because the taxpayer is making a "self-assessment" and immediately paying the resulting tax liability in full. [Emphasis added.]

C. Meeting the QAR Parameters

One of the biggest challenges for a taxpayer, of course, is persuading the IRS or the courts that the Form 1040X she files constitutes a QAR, as this term is narrowly defined.[35] For example, in *Perrah*,[36] the Tax Court rejected QAR status because the Forms 1040X were filed with the Service Center after the IRS had commenced an examination of the taxpayer. Likewise, in *Wilkerson*,[37] the Tax Court refused to classify Forms 1040X as QARs when the taxpayer filed them with the Appeals Office after the IRS issued a notice of deficiency and after the taxpayer filed a petition with the Tax Court. Finally, in *Bergmann*,[38] the Tax Court held that the taxpayer had not filed QARs because, by the time the Forms 1040X reached the IRS, it had already started a promoter investigation and issued summonses related to the pertinent transactions and years.[39]

Details about how to meet the QAR standards are presented below.

1. General criteria.

A Form 1040X ordinarily will not be a QAR, unless the taxpayer files it before any of the following events occur[40]:

- The date on which the IRS contacts the taxpayer concerning a civil examination or criminal investigation regarding the relevant Form 1040.[41]
- The date on which the IRS contacts any person concerning a tax shelter promoter investigation under section 6700 for an activity for which the taxpayer claimed any tax benefit on Form 1040 directly, or indirectly through an entity, plan, or arrangement.[42] This criterion applies "regardless of whether the IRS ultimately establishes that such person violated Section 6700."[43]
- For items attributable to a passthrough entity (that is, partnership, subchapter S corporation, estate, trust, regulated investment company, real estate investment trust, or real estate mortgage investment conduit), the date on which the IRS first contacts the passthrough entity in connection with the civil examination of the relevant return, such as Form 1065.[44]
- The date on which the IRS serves a summons relating to the tax liability of a person, group, or class that includes the taxpayer (or a passthrough entity of which the taxpayer is a partner, shareholder, beneficiary, or holder of a residual interest in a REMIC) regarding an activity for which the taxpayer claimed any tax benefit on his Form 1040, directly or indirectly.[45] This rule applies to any Form 1040 on which the taxpayer claimed a direct or indirect tax benefit from the type of activity that is the subject of the summons, regardless of whether the summons seeks the production

[35] To follow the evolution of the QAR criteria, see T.D. 8381; Notice 2004-38, 2004-1 C.B. 949; T.D. 9186; and T.D. 9309.

[36] *Perrah v. Commissioner*, T.C. Memo. 2002-283.

[37] *Wilkerson v. Commissioner*, T.C. Summ. Op. 2004-99.

[38] *Bergmann v. Commissioner*, 137 T.C. 136 (2011).

[39] There are several other cases in which the courts declined to grant taxpayers the benefit of QAR status. *See, e.g.*, *Perry v. Commissioner*, T.C. Memo. 2016-172 (taxpayer filed relevant Form 1040X after the IRS notified her of an examination); *Planty v. Commissioner*, T.C. Memo. 2017-240 (taxpayer filed Form 1040X after start of examination); *Scully v. Commissioner*, T.C. Memo. 2013-229 (taxpayer filed Forms 1040X and otherwise changed tax positions during the trial); and *Sampson v. Commissioner*, T.C. Memo. 2013-212 (taxpayer filed relevant Forms 1040X after the IRS notified him of an examination).

[40] Reg. section 1.6664-2(c)(3)(i).

[41] Reg. section 1.6664-2(c)(3)(i)(A).

[42] Reg. section 1.6664-2(c)(3)(i)(B).

[43] T.D. 9186, Preamble, Explanation of Provisions.

[44] Reg. section 1.6664-2(c)(3)(i)(C); the term "pass-through entity" is defined, by cross-reference, in reg. section 1.6662-4(f)(5).

[45] Reg. section 1.6664-2(c)(3)(i)(D)(1).

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of information for the taxable period covered by the Form 1040.[46]
- The date on which the IRS announces a settlement initiative to compromise or waive penalties, in whole or in part, regarding a listed transaction, and the taxpayer participated in the listed transaction during the relevant years.[47]

2. Special rules.

An expanded set of criteria applies in situations involving an "undisclosed listed transaction," which means a transaction that is the same as, or substantially similar, to a listed transaction, and that was not revealed to the IRS on a Form 8886.[48] For an undisclosed listed transaction for which the taxpayer claims either a direct or indirect tax benefit on his Form 1040 — regardless of whether the transaction had been identified by the IRS as a listed transaction at the time the taxpayer filed the Form 1040 — a Form 1040X will not be treated as a QAR, unless the taxpayer files it before any of the following events occurs:

- any of the five general criteria described above;[49]
- the date on which the IRS first contacts any person regarding an examination of that person's liability under section 6707 for not filing a Form 8918 regarding the undisclosed listed transaction in which the taxpayer participated;[50] or
- the date on which the IRS requests (from any person who made a tax statement to or for the benefit of the taxpayer, or from any person who gave the taxpayer material aid, assistance, or advice) the list required under section 6112 relating to a transaction that was the same as, or substantially similar to, the undisclosed listed transaction in which the taxpayer participated.[51] Those falling into the broad definition of material advisers must maintain for each reportable transaction a list of information about their clients, the reportable transactions in which they participated, the amount invested by the clients, the tax benefits obtained, and the material advisers involved.[52]

D. Examples of What Constitutes a QAR

The regulations contain examples illustrating the circumstances under which an amended return will achieve QAR status. The ones most relevant to this article are featured below.[53]

Example 1: T, an individual taxpayer, claimed tax benefits on his 2002 federal income tax return from a transaction that is substantially similar to the transaction identified as a listed transaction in Notice 2002-65, 2002-2 C.B. 690. T did not disclose his participation in this transaction on a Form 8886. On June 30, 2004, the IRS requested from P, T's material adviser, an investor list required to be maintained under section 6112. The section 6112 request, however, related to the type of transaction described in Notice 2003-81, 2003-2 C.B. 1223. T did not participate in a transaction described in Notice 2003-81. T may file a QAR relating to the transaction described in Notice 2002-65 because T did not claim a tax benefit regarding the listed transaction described in Notice 2003-81, which is the subject of the section 6112 request.

Example 2: Corp. X claimed tax benefits from a transaction on its 2002 federal income tax return. In October 2004 the IRS and Treasury identified the transaction as a listed transaction. In December 2004 the IRS contacted P concerning an examination of P's liability under section 6707(a). P is the organizer who provided representations to X regarding tax benefits from the transaction, and the IRS has contacted P about the failure to register that transaction. Three days later, X filed an amended return. X's amended return is not a

[46]Reg. section 1.6664-2(c)(3)(i)(D)(2).

[47]Reg. section 1.6664-2(c)(3)(i)(E).

[48]Reg. section 1.6664-2(c)(3)(ii).

[49]Reg. section 1.6664-2(c)(3)(ii)(A).

[50]Reg. section 1.6664-2(c)(3)(ii)(B).

[51]Reg. section 1.6664-2(c)(3)(ii)(C). A "tax statement" means any statement, oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction, including a listed transaction, and that is made to, or for the benefit of, specific persons, including a taxpayer who must file a Form 8886, a material adviser who must file a Form 8918, and others. *See* reg. section 301.6111-3(b)(2)(i).

[52]Section 6112; reg. section 301.6112-1.

[53]Reg. section 1.6664-2(c)(5).

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QAR because X did not disclose the transaction before the IRS contacted P. X's amended return would have been a QAR if had been submitted before the date on which the IRS contacted P.

Example 3: The facts are the same as in Example 2 except instead of contacting P concerning an examination under section 6707(a), in December 2004 the IRS served P with a John Doe summons relating to the tax liability of participants in the type of transaction for which X claimed tax benefits on its return. X cannot file a QAR after the John Doe summons has been served regardless of when, or whether, the transaction becomes a listed transaction.

E. Authority to Modify QAR Rules

Importantly, the regulations indicate that, despite the strict rules described above for satisfying the QAR standards, the commissioner has the authority to make exceptions. Regarding administrative flexibility, the regulations state: "The Commissioner may by Revenue Procedure prescribe the manner in which the rules . . . about [QARs] apply to particular classes of taxpayers."[54]

V. Conclusion

The existing situation creates a conundrum. On one hand, the commissioner, chief counsel, and others have publicly announced that the IRS is actively engaged in multiple efforts designed to halt SCETs, including (1) pursuing promoters, appraisers, return preparers, material advisers, accommodating entities, and charitable organizations; (2) conducting concurrent civil examinations and criminal investigations; and (3) auditing essentially all partnerships that participated in SCETs in 2016, with the audits of the 2017 partnerships getting underway in late 2019. On the other hand, the IRS issued two releases in November and December, featuring statements from the commissioner to taxpayers warning them "to take advantage of various methods of getting back into compliance by correcting [their] tax returns before [they] hear from the IRS," and "take immediate steps to resolve these matters," and avoid penalties by "timely filing a [QAR] or administrative adjustment request" to remove deductions related to SCETs.[55]

The problem is that many individual taxpayers are ineligible to file QARs now because the IRS has (1) started auditing their Forms 1040 because of significant easement-related deductions; (2) initiated promoter investigations against the organizers of the relevant partnerships; (3) commenced audits of the Forms 1065 of the partnerships for 2017 and prior years; (4) issued summonses to various parties as part of its investigations or audits; and (5) demanded from material advisers lists of data about clients, transactions, tax benefits, and more. In other words, while some taxpayers might consider heeding the suggestion by the commissioner to file a QAR, they simply cannot do so under the current rules.

The silver lining, as indicated above, is that the regulations expressly state that the commissioner, via a revenue procedure, may "prescribe the manner in which the rules . . . about [QARs] apply to particular classes of taxpayers."[56] Perhaps the commissioner will exercise his discretion to publish special guidance indicating the conditions under which Forms 1040X filed now by individual taxpayers who invested in partnerships that engaged in SCETs will be treated as QARs. That guidance might also explain whether taxpayers are expected to file Forms 1040X; Forms 8082, "Notice of Inconsistent Treatment or Administrative Adjustment Request"; or other materials. Individual taxpayers, their advisers, and the tax community are awaiting these important clarifications from the IRS. ■

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[54] Reg. section 1.6664-2(c)(4)(ii).

[55] IR-2019-182 and IR-2019-213.

[56] Reg. section 1.6664-2(c)(4)(ii).

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