

Current Federal Tax Developments

Week of February 10, 2020

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ACCOUNTING
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF FEBRUARY 10, 2020
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SECTION: 61

FINAL REGULATIONS ISSUED INCREASING MAXIMUM VALUE FOR VEHICLES ELIGIBLE FOR THE FAVR AND CENTS-PER-MILE VALUATION METHODS

Citation: TD 9893, 2/5/20

The IRS has released final regulations modifying the dollar limits for vehicles subject to a fleet average valuation rule or having personal use valued using the cents-per-mile valuation method found in Reg. §1.61-21.¹

The preamble to the final regulations describes these special rules as follows:

The amount that must be included in the employee's income and wages for the personal use of an employer-provided vehicle generally is determined by reference to the vehicle's fair market value (FMV). However, for many years, §1.61-21 has provided special valuation rules for employer-provided vehicles (the prior final regulations).¹ If an employer chooses to use a special valuation rule, the special value is treated as the FMV of the benefit for income tax and employment tax purposes. §1.61-21(b)(4). As discussed further in this Background section of this preamble, two such special valuation rules, the fleet-average valuation rule and the vehicle cents-per-mile valuation rule, are set forth in §1.61-21(d)(5)(v) and §1.61-21(e), respectively. These two special valuation rules are subject to limitations, including that they may be used only in connection with vehicles having values that do not exceed a maximum amount set forth in the regulations.²

The prior final regulations limited the cost of such vehicles to \$12,800 for the cents-per-mile valuation method and \$16,500 for a vehicle valued under the fleet-average valuation rule, subject to adjustment for inflation

The preamble to the proposed regulations provides the following description of the allowed use of a fleet-average valuation rule:

The fleet-average valuation rule is an optional component of a special valuation rule called the automobile lease valuation rule set forth in §1.61-21(d). Under the automobile lease valuation rule, the value of the personal use of an employer-provided automobile available to an employee for an entire year is the portion of the annual lease value determined under the regulations (Annual Lease Value) relating to the

¹ TD 9893, February 5, 2020, https://s3.amazonaws.com/public-inspection.federalregister.gov/2020-02158.pdf?utm_campaign=pi+subscription+mailing+list&utm_source=federalregister.gov&utm_medium=email (retrieved February 4, 2020)

² TD 9893, p. 2

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availability of the automobile for personal use. Furthermore, provided the FMV of the automobile does not exceed the maximum value permitted under §1.61-21(d)(5)(v), an employer with a fleet of 20 or more automobiles may use a fleet-average value for purposes of calculating the Annual Lease Value of any automobile in the fleet.

The fleet-average value is the average of the fair market values of all the automobiles in the fleet. However, §1.61-21(d)(5)(v)(D) of the prior final regulations provided that the value of an employee's personal use of an automobile could not be determined under the fleet-average valuation rule for a calendar year if the FMV of the automobile on the first date the automobile was made available to the employee exceeded the base value of \$16,500, as adjusted annually pursuant to section 280F(d)(7). Section 1.61-21(d)(5)(v)(D) provided that the first such adjustment would be for calendar year 1989, subject to minor modifications to the section 280F(d)(7) formula specified in the regulations. In other words, under the prior final regulations, the maximum value for use of the fleet-average valuation rule was the base value of \$16,500, as adjusted annually under section 280F(d)(7) every year since 1989.

...Section 1.61-21(d)(5)(v)(B) provides that the fleet-average valuation rule may be used by an employer as of January 1 of any calendar year following the calendar year in which the employer acquires a sufficient number of automobiles to total a fleet of 20 or more, each one satisfying the maximum value requirement of §1.61-21(d)(5)(v)(D). The Annual Lease Value calculated for automobiles in the fleet, based on the fleet-average value, must remain in effect for the period that begins with the first January 1 the fleet-average valuation rule is applied by the employer to the automobiles in the fleet and ends on December 31 of the subsequent calendar year. The Annual Lease Value for each subsequent two-year period is calculated by determining the fleet average value of the automobiles in the fleet as of the first January 1 of such period. An employer may cease using the fleet-average valuation rule as of any January 1.³

As well, it goes on to describe the cents-per-mile valuation method:

Another special valuation rule is the vehicle cents-per-mile rule in §1.61-21(e). Under §1.61-21(e), if an employer provides an employee with the use of a vehicle that the employer reasonably expects will be regularly used in the employer's trade or business throughout the calendar year (or such shorter period as the vehicle may be owned or leased by the employer), or that satisfies the requirements of §1.61-21(e)(1)(ii) (i.e., the vehicle is actually driven at least 10,000 miles in the year and use of the vehicle during the year is primarily by employees), the value of the personal use may be determined based on the

³ TD 9893, pp. 3-5

applicable standard mileage rate multiplied by the total number of miles the vehicle is driven by the employee for personal purposes.

Section 1.61-21(e)(1)(iii)(A) provides that the value of the personal use may not be determined under the vehicle cents-per-mile valuation rule for a calendar year if the fair market value of the vehicle on the first date the vehicle is made available to the employee exceeds the sum of the maximum recovery deductions allowable under section 280F(a) for a five-year period for an automobile first placed in service during that calendar year (whether or not the automobile is actually placed in service during that year), as adjusted by section 280F(d)(7). The prior final regulations provided that, under this rule, with respect to a vehicle placed in service in or after 1989, the limitation on value was \$12,800, as adjusted under section 280F(d)(7). In other words, under the prior final regulations, the maximum value of a vehicle for use of the vehicle cents-per-mile valuation rule was the base value of \$12,800, as adjusted annually under section 280F(d)(7) since 1989. As with the fleet-average valuation rule, beginning in 2005, the IRS calculated the price inflation adjustment for trucks and vans separately from cars. See Rev. Proc. 2005-48. For 2017, the maximum value for use of the vehicle cents-per-mile valuation rule was \$15,900 for a passenger automobile and \$17,800 for a truck or van. See Notice 2017-03.

Section 1.61-21(e)(5)(i) states that an employer must adopt the vehicle cents-per-mile valuation rule for a vehicle to take effect by the first day on which the vehicle is used by an employee of the employer for personal use (or, if another special valuation rule called the commuting valuation rule of §1.61-21(f) is used when the vehicle is first used by an employee of the employer for personal use, the first day on which the commuting valuation rule is not used). Section 1.61-21(e)(5)(ii) also provides, in part, that once the vehicle cents-per-mile valuation rule has been adopted for a vehicle by an employer, the rule must be used by the employer for all subsequent years in which the vehicle qualifies for use of the rule, except that the employer may, for any year during which use of the vehicle qualifies for the commuting valuation rule of §1.61-21(f), use the commuting valuation rule with respect to the vehicle.⁴

The preamble notes that the Tax Cuts and Jobs Act (TCJA) substantially increased the cap on the maximum deductible depreciation for automobiles and revised the cost of living adjustment to be computed using both the CPI auto component and the Chained Consumer Price Index for All Urban Consumers (C-CPI-U) automobile component.⁵

Those changes have led to the need to revise the dollar limits upward substantially for these two valuation methods. The IRS announced their intent to revise the regulations

⁴ TD 9893, pp. 5-6

⁵ TD 9893, p. 7

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to accomplish this and provided 2018 values in Notice 2019-08. This notice was followed up with 2019 numbers found in Notice 2019-34.⁶

On August 29, 2019 the proposed regulations to implement these changes were published in the *Federal Register* by the Treasury Department.⁷ No comments were received, so the final regulations were adopted without substantive changes.⁸

Thus, Reg. §1.61-21(d)(5)(v)(D) related to the use of the fleet-average valuation rule is modified to read as follows:

(D) Limitations on use of fleet-average rule. The rule provided in this paragraph (d)(5)(v) may not be used for any automobile the fair market value of which (determined pursuant to paragraphs (d)(5)(i) through (iv) of this section as of the first date on which the automobile is made available to any employee of the employer for personal use) exceeds \$50,000, as adjusted by section 280F(d)(7). The first such adjustment shall be for calendar year 2019. In addition, the rule provided in this paragraph (d)(5)(v) may only be used for automobiles that the employer reasonably expects will regularly be used in the employer's trade or business. For rules concerning when an automobile is regularly used in the employer's business, see paragraph (e)(1)(iv) of this section.⁹

The revised regulation applies to tax years beginning on or after February 5, 2020, but taxpayers can apply the changes for tax years beginning on or after January 1, 2018.¹⁰

A special transition rule is also in place for 2018 and 2019. The provision provides:

(G) Transition rule for 2018 and 2019. Notwithstanding paragraph (d)(5)(v)(B) of this section, an employer that did not qualify to use the fleet-average valuation rule prior to January 1, 2018, with respect to any automobile (including a truck or van) because the fair market value of the vehicle exceeded the inflation-adjusted maximum value requirement of paragraph (d)(5)(v)(D) of this section, as published by the Service in a notice or revenue procedure applicable to the year the vehicle was first made available to any employee of the employer, may adopt the fleet-average valuation rule for 2018 or 2019 with respect to the vehicle, provided the fair market value of the vehicle does not

⁶ TD 9893, pp. 7-8

⁷ *Federal Register*, 84 FR 44258, August 23, 2019

⁸ TD 9893, p. 12

⁹ Reg. §1.61-21(d)(5)(v)(D)

¹⁰ Reg. §1.61-21(d)(5)(v)(H)

exceed \$50,000 on January 1, 2018, or \$50,400 on January 1, 2019, respectively.¹¹

For the cents-per-mile valuation method, the regulations are first changed at Reg. §1.61-21(e)(1)(iii)(A) to say:

(A) In general. The value of the use of an automobile (as defined in paragraph (d)(1)(ii) of this section) may not be determined under the vehicle cents-per-mile valuation rule of this paragraph (e) for a calendar year if the fair market value of the automobile (determined pursuant to paragraphs (d)(5)(i) through (iv) of this section as of the first date on which the automobile is made available to any employee of the employer for personal use) exceeds \$50,000, as adjusted by section 280F(d)(7). The first such adjustment shall be for calendar year 2019.¹²

As well, Reg. §1.61-21(e)(5)(i) is revised to read:

(i) Use of the vehicle cents-per-mile valuation rule by an employer. An employer must adopt the vehicle cents-per-mile valuation rule of this paragraph (e) for a vehicle to take effect by the first day on which the vehicle is used by an employee of the employer for personal use (or, if the commuting valuation rule of paragraph (f) of this section is used when the vehicle is first used by an employee of the employer for personal use, the first day on which the commuting valuation rule is not used).¹³

As with the FAVR rule, these regulation changes are effective for taxable years beginning on or after February 5, 2020, with taxpayers being given the option to apply these rules to tax years beginning on or after January 1, 2018.¹⁴

Similarly, a special transition rule for the cents-per-mile valuation method is provided for 2018 and 2019:

(vi) Transition rule for 2018 and 2019. For a vehicle first made available to any employee of an employer for personal use before calendar year 2018, an employer that did not qualify under this paragraph (e)(5) to adopt the vehicle cents-per-mile valuation rule on the first day on which the vehicle is used by the employee for personal use because the fair market value of the vehicle exceeded the inflation-adjusted limitation of paragraph (e)(1)(iii) of this section, as published by the Service in a notice or revenue procedure applicable to the year the vehicle was first used by the employee for personal use, may first

¹¹ Reg. §1.61-21(d)(5)(v)(G)

¹² Reg. §1.61-21(e)(1)(iii)(A)

¹³ Reg. §1.61-21(e)(5)(i)

¹⁴ Reg. §1.61-21(e)(6)

adopt the vehicle cents-per-mile valuation rule for the 2018 or 2019 taxable year, provided the fair market value of the vehicle does not exceed \$50,000 on January 1, 2018, or \$50,400 on January 1, 2019, respectively. Similarly, for a vehicle first made available to any employee of the employer for personal use before calendar year 2018, if the commuting valuation rule of paragraph (f) of this section was used when the vehicle was first used by the employee for personal use, and the employer did not qualify to switch to the vehicle cents-per-mile valuation rule of this paragraph (e) on the first day on which the commuting valuation rule of paragraph (f) of this section was not used because the vehicle had a fair market value in excess of the inflation-adjusted limitation of paragraph (e)(1)(iii) of this section, as published by the Service in a notice or revenue procedure applicable to the year the commuting valuation rule was first not used, the employer may adopt the vehicle cents-per-mile valuation rule for the 2018 or 2019 taxable year, provided the fair market value of the vehicle does not exceed \$50,000 on January 1, 2018, or \$50,400 on January 1, 2019, respectively. However, in accordance with paragraph (e)(5)(ii) of this section, an employer that adopts the vehicle cents-per-mile valuation rule pursuant to this paragraph (e)(5)(vi) must continue to use the rule for all subsequent years in which the vehicle qualifies for use of the rule, except that the employer may, for any year during which use of the vehicle qualifies for the commuting valuation rule of paragraph (f) of this section, use the commuting valuation rule with regard to the vehicle.¹⁵

SECTION: 163

OIRA COMPLETES REVIEW OF FINAL §163(J) REGULATIONS AND BEGINS REVIEW OF ADDITIONAL PROPOSED §163(J) REGULATIONS

Citation: OIRA Postings on Status of Regulatory Review, §163(j) Final and Proposed Regulations, 2/4/20 and 2/7/20

The last official guidance we received on the application of the business interest limitation under IRC §163(j) arrived late in 2018 with proposed regulations. We now have signs that additional guidance is on the way, both in terms of final regulations¹⁶ and additional proposed regulations¹⁷ based on regulatory review information posted

¹⁵ Reg. §1.61-21(e)(5)(vi)

¹⁶ Rules Regarding Business Interest Limitation Under Section 163(j) [TCJA], Stage: Final Rule, RIN 1545-BO73, January 31, 2020, <https://www.reginfo.gov/public/do/eoDetails?rriid=129917> (retrieved February 8, 2020)

¹⁷ Limitation on Deduction for Business Interest Earned, Stage: Proposed Rule, RIN 1545-BP73, February 7, 2020,

on the website of the Office of Information and Regulatory Affairs (OIRA). However, we are still a bit in the dark on exactly when the guidance will be seen—and, more to the point, whether it will emerge before or after the first 2019 return original due dates arrive.

OIRA first posted notification that it had completed its review of §163(j) final regulations, based on the 2018 proposed regulations. While the posting indicated the review had been completed on January 31, 2020,¹⁸ the information does not appear to have been posted on OIRA’s website until February 4, 2020.¹⁹

In a *Tax Notes Today Federal* article, Emily Foster summarized what information has been released to date on what will likely be in the final regulations:

The final regulations follow up on 2018 proposed rules (REG-106089-18) that drew criticism concerning, among other things, Treasury’s perceived regulatory authority to broadly define interest and entity-specific issues for partnerships, consolidated groups, and controlled foreign corporations.

Treasury and the IRS have said the regs will reflect significant changes to the proposed rules and address myriad issues, including the definition of interest, the computation of adjusted taxable income, and the small business exception.²⁰

However, as is also noted in that article, Bryan Rimmke, attorney-adviser, Treasury Office of Tax Legislative Counsel had indicated in January at the District of Columbia Bar conference that the final rules would likely be released along with proposed regulations dealing with issues not covered in the first set of proposed regulations.²¹

<https://www.reginfo.gov/public/do/eoDetails?rrid=130070> (retrieved February 8, 2020)

¹⁸ Rules Regarding Business Interest Limitation Under Section 163(j) [TCJA], Stage: Final Rule, RIN 1545-BO73, January 31, 2020

¹⁹ Emily Foster, “Final Interest Regs Leave OIRA; No Sighting of Second Batch,” *Tax Notes Today Federal*, February 5, 2020, 2020 TNTF 24-1, <https://www.taxnotes.com/tax-notes-today-federal/debt-instruments/final-interest-regs-leave-oira-no-sighting-second-batch/2020/02/05/2c4nh> (retrieved February 8, 2020, subscription required)

²⁰ Emily Foster, “Final Interest Regs Leave OIRA; No Sighting of Second Batch,” *Tax Notes Today Federal*, February 5, 2020

²¹ Emily Foster, “Final Interest Regs Leave OIRA; No Sighting of Second Batch,” *Tax Notes Today Federal*, February 5, 2020

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Eric Yauch, reporting on that presentation, indicated that Mr. Rimmke provided the following reason why Treasury wants both sets to be issued at the same time:

Treasury hopes to release the final regulations under section 163(j) at the same time as the proposed regs because the preamble to the final regs refers to them, Rimmke said at the District of Columbia Bar conference in Washington on January 23.²²

What appears to be this promised set of proposed regulations was submitted to OIRA on February 7, 2020.²³

Presumably the final regulations will not be released by Treasury until OIRA has completed its review of these proposed regulations. The final regulations took nearly one and a half months to clear the review process, and a number of other Treasury regulations are already under OIRA review at this point. Thus, unless these regulations get fast-tracked by OIRA through the process or Treasury changes its mind and releases the final regulations first, we could very well see these regulations arrive towards the end of tax season or even after.

The final §163(j) regulations were reported to be over 550 pages long by Treasury Assistant Secretary for Tax Policy David Kautter in comments he made to the AICPA National Tax Conference in November 2019.²⁴

SECTION: 170 LANGUAGE IN EXTINGUISHMENT CLAUSE IN DEED DOOMS CONSERVATION EASEMENT DEDUCITON

Citation: Railroad Holdings, LLC v. Commissioner, TC Memo 2020-22, 2/5/20

A taxpayer's attempted donation of a conservation easement that qualified for a deduction under IRC §170(h) was found not to meet the requirement that the easement was "protected in perpetuity" in the case of *Railroad Holdings, LLC v. Commissioner*, TC

²² Eric Yauch, "Treasury Hopes to Release Final Interest Limit Rules as Package," *Tax Notes Today Federal*, January 24, 2020, 2020 TNTF 16-3, <https://www.taxnotes.com/tax-notes-today-federal/tax-cuts-and-jobs-act/treasury-hopes-release-final-interest-limit-rules-package/2020/01/24/2c3d3> (retrieved February 8, 2020, subscription required)

²³ Limitation on Deduction for Business Interest Earned, Stage: Proposed Rule, RIN 1545-BP73, February 7, 2020

²⁴ Kristen A. Parillo, "Carried Interest, SALT Among Imminent TCJA Guidance," *Tax Notes Today Federal*, November 14, 2019, 2019 TNTF 221-1, <https://www.taxnotes.com/tax-notes-today-federal/tax-cuts-and-jobs-act/carried-interest-salt-among-imminent-tcja-guidance/2019/11/14/2b451> (retrieved February 8, 2020, subscription required).

Memo 2020-22.²⁵ The problem arose from a clause that detailed what would happen if the easement were extinguished due to judicial proceedings.

IRC §170(h) provides a charitable contribution deduction for contributions of conservation easements that meet certain requirements. One of these, found at IRC §170(h)(5)(A), is that the conservation purpose must be protected in perpetuity.

Sometimes circumstances arise when property is subject to a forced judicial sale. Reg. §1.170A-14(g)(6)(ii) provides that the transfer must be made with the following agreement to deal with such a possible event in the future:

In case of a donation made after February 13, 1986, for 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. See section 1.170A-14(h)(3)(iii) relating to the allocation of basis. 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.²⁶

Thus, if the easement is found to be equal to 10% of the value of the property at the date of the donation, the charity must receive 10% of the proceeds of any future judicial sale in the future that extinguishes this interest.

In this case, the agreement provided the following to deal with such a forced sale:

(2) This Conservation Easement gives rise to a real property right and interest immediately vested in SERLC. For purposes of this Conservation Easement, the fair market value of SERLC's right and interest (which value shall remain constant) shall be equal to the difference between (a) the fair market value of the Conservation Area as if not burdened by this Conservation Easement and (b) the fair market value of the Conservation Area burdened by this Conservation Easement, as such values are determined as of the date of this Conservation Easement. If a change in conditions makes impossible

²⁵ *Railroad Holdings, LLC v. Commissioner*, TC Memo 2020-22, February 5, 2020, <https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12168> (retrieved February 8, 2020)

²⁶ Reg. §1.170A-14(g)(6)(ii)

or impractical any continued protection of the Conservation Area for conservation purposes, the restrictions contained herein may only be extinguished by judicial proceeding. Upon such proceeding, SERLC, upon a subsequent sale, exchange or involuntary conversion of the Conservation Area, shall be entitled to a portion of the proceeds at least equal to the fair market value of the Conservation Easement as provided above. SERLC shall use its share of the proceeds in a manner consistent with the conservation purposes set forth in the Recitals herein.

(3) Whenever all or part of the Conservation Area is taken in exercise of eminent domain by public, corporate, or other authority so as to abrogate the restrictions imposed by this Conservation Easement, Owner and SERLC shall join in appropriate actions at the time of such taking to recover the full value of the taking and all incidental or direct damages resulting from the taking, which proceeds shall be divided in accordance with the proportionate value of SERLC's and Owner's interests as specified above. All expenses, including attorneys' fees, incurred by Owner and SERLC in such action shall be paid out of the recovered proceeds to the extent not paid by the condemning authority.²⁷

The IRS argues that the clause effectively holds the charity's payment constant, equal to the value on the date of the contribution, rather than giving the charity the percentage of the eventual proceeds. For example, if the property in total was worth \$160 million at the time of the contribution and the easement was worth \$16 million (10% of the value), if the property is subject to a forced sale when the property is worth \$300 million, the charity would end up only with \$16 million under this formula, far less than 10% of the value of the property.

The Tax Court agreed with the IRS that the agreement does not meet the requirements of the regulations, noting:

Though the deed incorporates from the regulation the phrase "proportionate value", the deed does not create a proportion or fraction that represents the donee's share of the property right, and hence a corresponding fraction of proceeds to which the donee is perpetually entitled. See *PBBM-Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193, 205-206 (5th Cir. 2018). Rather, the deed determines instead a "proportionate value * * * at the time of the gift" — meaning a dollar value that "shall remain constant" — and guarantees only that "constant" amount (i.e., that fixed dollar amount) for the donee. The defect can be illustrated as follows:

If the easement contributed by Railroad Holdings' deed were, at the time of the contribution, worth 10% of the value of a \$10 million property, then the "proportionate value" of the easement (as the deed uses that term) would be \$1 million, and that dollar value — rather than the fraction of value it did represent — "shall remain constant".

²⁷ *Railroad Holdings, LLC v. Commissioner*, p. 5

Thus, if a court extinguished the easement many years later after the property had appreciated to \$20 million, the donee's share of extinguishment proceeds would be not 10% of \$20 million (i.e., the fractional share represented by \$2 million) but rather the "constant" \$1 million. The regulation requires that the donee "must be entitled to a portion of the proceeds at least equal to that proportionate value" (in this example, 10% of \$20 million, or \$2 million), 26 C.F.R. sec. 1.170A-14(g)(6)(ii), but *Railroad Holdings*' deed would give the donee only "at least" a constant 10% of the \$10 million value "as of the date of" the contribution, or \$1 million. (As we explain below in Part IV.A, an entitlement to an amount that is "at least" a fixed value is an entitlement only to no less than that value.)²⁸

The taxpayer points to the term "at least" in the provision, arguing that the clause does not limit the charity to receiving only that minimum amount. But the Tax Court does not find that this saves the deduction, noting:

The totality of the "plain language" and "specific terms" on which this contention rests is the single phrase "at least", and that phrase will not bear the weight that petitioner's argument must put on it. Petitioner's explanation of "split[ting]" "proceeds [that] exceed" the date-of-donation values is an invention with no basis in the text of the deed.

The regulation sets a minimum for the donee's participation in extinguishment proceeds and then, using the phrase "at least", makes it explicit that a deed may be more generous to the donee and still comply. But a deed that provides for the donee a share of proceeds that may be less than the minimum cannot comply by adding "at least" to its deficient formula. The donee must obtain through the deed a "property right" that includes a proportionate share of proceeds. If the donee's only right under the deed is to receive "at least" a deficient share, with a hope that there might be more, then the deed does not comply with the regulation.²⁹

The Tax Court also found that a declaration of intent by an officer of the charity that the language reflected the charity's intent to be in full compliance with all IRC provisions for this donation also is not relevant. The Court notes the key issue would be the donor's intent, not that of the charity, and even if it is also the donor's intent, the deed itself fails to conform to the requirement. The Court notes that the declaration does not indicate there was an error in drafting. As well, the taxpayer did not provide evidence that State law would allow the use of other evidence to show the intended meaning, nor that such other evidence existed.³⁰

²⁸ *Railroad Holdings, LLC v. Commissioner*, pp. 11-12

²⁹ *Railroad Holdings, LLC v. Commissioner*, pp. 14-15

³⁰ *Railroad Holdings, LLC v. Commissioner*, pp. 15-16

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The taxpayer argues finally that the following provision, found in the deed, should serve to correct any ambiguity that might exist based on the “at least” clause:

Any general rule of construction to the contrary notwithstanding, this Conservation Easement shall be liberally construed in favor of the grant to protect the Conservation Values and effect the policies and purposes of SERLC. If any provision of this Conservation Easement is found to be ambiguous, an interpretation consistent with its conservation purposes that would render the provision valid should be favored over any interpretation that would render it invalid.³¹

The Tax Court does not find this argument persuasive either. First, the Court notes that the clause refers only to the portion of the agreement related to the “conservation purpose” and not the “protection in perpetuity” clause.

As well, it would only come into effect to resolve an ambiguity—but the formula for allocating the proceeds is not at all ambiguous in the deed.

Finally, even if we accept that it applied to this issue and there was ambiguity, the Court finds that it would represent an impermissible savings clause. As the Court notes:

A donor cannot reserve in an easement deed a right that section 170(h) does not permit (such as a right to more than his share of extinguishment proceeds) but then save his charitable contribution by mentioning the rule he has violated and calling for that rule to kick in and save the day if his violation subsequently comes to light.

Part B(2) of article VI of the deed contains an unambiguous expression of the formula to apply to the proceeds of an extinguishment. If the terms of part B(2) had never come to light in a tax proceeding, and if later the easement had ever been judicially extinguished, there is no reason to suppose that a court distributing proceeds would have overruled the express terms of part B(2).³²

In the end, the Tax Court concluded that as the easement was not protected in perpetuity, the entire \$16 million deduction was properly denied by the IRS.

³¹ *Railroad Holdings, LLC v. Commissioner*, p. 17

³² *Railroad Holdings, LLC v. Commissioner*, pp. 18-19

SECTION: 501 FORM 1023 MUST BE FILED ELECTRONICALLY BY ORGANIZATIONS APPLYING FOR §501(C)(3) EXEMPT STATUS

Citation: Revenue Procedure 2020-8, 1/31/20

Entities looking to apply for tax-exempt status under IRC §501(c)(3) on Form 1023 (*Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*) now must submit that form electronically. In Revenue Procedure 2020-8³³ the IRS updated the procedures under Revenue Procedure 2020-5 to mandate that applications for exempt organization determination letters must be handled electronically for applications after January 31, 2020. However, the procedure does provide for a temporary 90-day transition relief period.

IRS News Release IR-2020-25³⁴ provides the following summary of the changes:

Beginning January 31, 2020, applications for recognition of exemption on Form 1023 must be submitted electronically online at Pay.gov. The IRS will provide a 90-day grace period during which it will continue to accept paper versions of Form 1023 (Rev. 12-2017).

The required user fee for Form 1023 will remain \$600 for 2020. Applicants must pay the fee through Pay.gov when submitting the form. Payment can be made directly from a bank account or by credit or debit card.

The Form 1023-EZ previously had been accepted only electronically, so this simply makes all applicants use the electronic system once the grace period ends.

Section 4 of Revenue Procedure 2020-5 provides the following 90-day transition relief, which will run through April 30:

The Internal Revenue Service will accept for processing a completed paper Form 1023 accompanied by the correct user fee, as described in Rev. Proc. 2020-5, without applying the modifications of this revenue procedure, if the submission of the Form 1023 is postmarked on or

³³ Revenue Procedure 2020-8, January 31, 2020, <https://www.irs.gov/pub/irs-drop/rp-20-08.pdf> (retrieved February 2, 2020)

³⁴ “IRS revises Form 1023 for applying for tax-exempt status,” News Release IR-2020-25, January 31, 2020, <https://www.irs.gov/newsroom/irs-revises-form-1023-for-applying-for-tax-exempt-status> (retrieved February 2, 2020)

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before the date that is 90 days after the effective date of this revenue procedure.³⁵

Once that period expires, it appears the IRS does not plan to offer any sort of paper filing option to applicants:

Except as provided in section 4.02, an organization seeking recognition of tax exempt status under § 501(c)(3) using Form 1023 must electronically submit the form and user fee online at www.pay.gov.³⁶

The IRS's intent to move to mandatory electronic filing of these forms was announced in October 2019. Questions had been raised regarding issues that could arise with these changes.

In December 2019, the IRS issued a letter responding to a query by two attorneys with Jones Day.³⁷ First the letter addressed the question of whether an applicant would be able to download a copy of their completed electronically filed Form 1023.

You asked if an applicant will be able download an exact copy of their electronically submitted Form 1023 in a format that is easy to read and understand. Yes, applicants will be able to download an exact copy of the form and the attachment submitted in an easily readable PDF file format. Applicants will access the Form 1023 PDF file and attachment through their Pay.gov accounts.³⁸

The letter also addressed a concern that arose based on the size limits on attachments in the electronic filing system:

You also asked what mechanism will be offered to an applicant that wishes to submit more pages of attachments than the electronic system allows. Form 1023 on Pay.gov will accept a single PDF file, up to 15MB. If the PDF file exceeds the 15MB limit, the applicant should remove any items over the limit and contact IRS Customer Accounts Services (CAS) at 877-829-5500 for assistance on how to submit the removed items. CAS will provide the applicant a fax number, allowing

³⁵ Revenue Procedure 2020-8, Section 4.02

³⁶ Revenue Procedure 2020-8, Section 4.01

³⁷ "IRS Answers Practitioners' Questions on E-Filing of EO Applications," Author: Margaret Von Lienen,

Director, Exempt Organizations and Government Entities (Internal Revenue Service), *Tax Notes Today Federal*, 2020 TNTF 2-16, December 19, 2019, <https://www.taxnotes.com/tax-notes-today-federal/exempt-organizations/irs-answers-practitioners-questions-e-filing-eo-applications/2020/01/03/2bqxt> (Subscription required, retrieved February 2, 2020)

³⁸ "IRS Answers Practitioners' Questions on E-Filing of EO Applications"

the material to be faxed to the IRS to complete the application. This information will be available on the Form 1023 Pay.gov landing page as well as in the Instructions for Form 1023.³⁹

That is, the paperless submission will be followed up with paper-based fax submissions to contain the additional material when the application is larger than the electronic system is capable of handling.

In a *Tax Notes Today Federal* article regarding the IRS announcement, Gerald Griffith of Jones Day, one of the authors of the inquiry that led to the December letter, is cited as cautioning charities that this process may lead to the availability of a completed Form 1023 online via the IRS's own site, or posted on sites such as Guidestar, the National Center for Charitable Statistics, or *ProPublica*.⁴⁰

The article continues:

“So in the future, any stakeholder may be able to easily access the [Form] 1023 without the organization’s knowledge instead of having to ask the organization or the IRS for a copy,” Griffith said.⁴¹

³⁹ “IRS Answers Practitioners’ Questions on E-Filing of EO Applications”

⁴⁰ Fred Stokeld, “Mandatory E-Filing of EO Form Arrives,” *Tax Notes Today Federal*, February 3, 2020, <https://www.taxnotes.com/tax-notes-today-federal/exempt-organizations/mandatory-e-filing-EO-form-arrives/2020/02/03/2c4cm> (retrieved February 2, 2020, subscription required).

⁴¹ Fred Stokeld, “Mandatory E-Filing of EO Form Arrives,” *Tax Notes Today Federal*, February 3, 2020, <https://www.taxnotes.com/tax-notes-today-federal/exempt-organizations/mandatory-e-filing-EO-form-arrives/2020/02/03/2c4cm> (retrieved February 2, 2020, subscription required).