The Accuser Becomes the Accused in Conservation Easement Disputes: Courts Hold that IRS Violated the Law in *Green Valley Investors* and Elsewhere

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Although the decision in *Green Valley Investors* only addresses the Reportable Transaction Penalty on the surface, it could have other implications and trigger many questions.

The Internal Revenue Service ("IRS") has been attacking conservation easement donations for many years, both in court and in public. Perhaps the IRS's biggest tool in carrying out its aggressive compliance campaign is Notice 2017-10, issued in late 2016. It announced that the IRS planned to challenge every so-called syndicated conservation easement transaction ("SCET"), disallow all related tax benefits, and impose various penalties. Notice 2017-10 also obligated "participants" and "material advisors" to file specific information returns, thereby alerting the IRS to the situation immediately. The data on such returns facilitated and expedited audits, which the IRS surely liked. What the IRS does not like, though, is that the Tax Court recently held in *Green Valley Investors, LLC v. Commissioner* that it violated the Administrative Procedures Act ("APA") when it issued Notice 2017-10, thus rendering it invalid from the start.[1] In other words, the party constantly accusing taxpayers of breaking the law when it comes to SCETs, the IRS, has broken the law itself.

This article explores disclosure duties for taxpayers, their relevance in the conservation easement context, recent APA violations by the IRS with respect to income-related penalties, other APA problems focused on disclosure-related penalties, and multiple questions triggered by the invalidation of Notice 2017-10.

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Manners of Disclosing to the IRS

The IRS has trouble auditing transactions and halting the ones it opposes when it cannot effectively identify them. Therefore, the IRS obligates or encourages taxpayers to report them pro-actively, depending on the situation. Filing Forms 8886 (Reportable Transaction Disclosure Statement) and/or Forms 8275 (Disclosure Statement) constitute the most prevalent disclosure methods for participants.[2] This article examines both, below.

Form 8886

The IRS has been wielding a big stick for decades when it comes to forcing taxpayers to divulge participation in certain transactions.

Evolution of Regulations

The IRS has published several versions of regulations in connection with reportable transactions over the years.[3] The first set of proposed and temporary regulations, issued in March 2000, focused on disclosure by *corporate* taxpayers.[4] At that time, the IRS was concerned about the proliferation of corporate tax shelters, and the regulations were intended to give the IRS early notification of large transactions that "may be indicative of such tax shelter activity."[5]

The IRS expanded the reach of the disclosure requirements in June 2002. From that point forward, they would apply not only to corporations, but also to individuals, trusts, partnerships, and S corporations that participated in reportable transactions.[6]

The IRS changed course in October 2002 when it discovered, unsurprisingly, that taxpayers were interpreting the characteristics of tax shelters in an "overly narrow manner," while simultaneously construing the exceptions to such characteristics in an "overly broad manner."[7] The IRS created rules that were more objective in an effort to remedy this.[8]

The IRS issued final regulations in March 2003.[9] They warned that the relevant years were broader than taxpayers might anticipate. Specifically, if a reportable transaction results in a loss that is *carried back* to a prior year, then the taxpayer must enclose Form 8886 with the application for tentative refund or amended return for the prior year.[10] Conversely, if a taxpayer were to participate in a reportable transaction in one year and *carry forward* a portion of the benefit, then he would be participating in the later years and would thus need to file Forms 8886.

Substantially Similar Transactions

The duty to file Forms 8886 applies not only to reportable transactions, but also to those that are "substantially similar." This term covers any transaction, which is expected to obtain the same or similar tax consequences as a reportable transaction, and which is either factually similar or based on a similar tax strategy.[11] The regulations underscore that taxpayers must broadly construe the term substantially similar in favor of making disclosures to the IRS.[12] They also state that a transaction may be substantially similar to a reportable transaction, even though it involves different entities and/or applies different tax provisions.[13]

The regulations contain several examples demonstrating just how liberally the IRS interprets the notion of substantially similar.[14] The IRS has also issued multiple Private Letter Rulings, Field Service Advisories, General Counsel Memos, and other guidance over the years concluding that particular transactions are substantially similar to one reportable transaction or another.[15] The courts, likewise, have expansively interpreted the concept of substantially similar in upholding penalties related to Forms 8886.[16]

Recapping

In summary, the IRS has been using a stick for more than two decades, obligating taxpayers who participate in reportable transactions (or those that are substantially similar) to file Forms 8886. Taxpayers must enclose Forms 8886 with their original or amended tax returns, as well as send a copy to the specialized Office of Tax Shelter Analysis for the first year of participation.[17]

Downsides of Non-Compliance

Those who fail to satisfy Form 8886 requirements face penalties, extended assessment-periods, and more, as explained below.

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1 *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5 (2022); Kristen A. Parillo, "Easement Listing Notice Violated APA, Tax Court Holds," 2022 Tax Notes Today Federal 217-2 (Nov. 10, 2022).

2 Those classified as "material advisors" to reportable transactions have various disclosure and record-keeping duties, too, but this article does not cover them in detail. *See* Section 6111 and Section 6112.

3 *See* T.D. 8875 (March 2, 2000); T.D. 8876 (March 2, 2000); T.D. 8877 (March 2, 2000); T.D. 8896 (Aug. 16, 2000); T.D. 8961 (Aug. 7, 2001); T.D. 9000 (June 18, 2002); T.D. 9017 (Oct. 22, 2002); T.D. 9018 (Oct. 22, 2002); T.D. 9046 (March 4, 2003); T.D. 9108 (Dec. 30, 2003); T.D. 9350 (Aug. 3, 2007).

4 T.D. 8877 (March 2, 2000); REG-103735-00.

5 T.D. 8877 (March 2, 2000), Preamble.

6 T.D. 9000 (June 18, 2002), Preamble; Temp. Reg. § 1.6011-1T(a)(1).

7 T.D. 9017 (Oct. 22, 2002), Preamble.

8 *Id.*

9 T.D. 9046 (March 4, 2003).

10 Treas. Reg. § 301.6707A-1(c)(1) and (c)(2), Example 3.

11 Treas. Reg. § 301.6011-4(c)(4).

12 *Id.*

13 *Id.*

14 Treas. Reg. § 301.6011-4(c)(4), Example s.

15 *See, e.g.*, Private Letter Ruling 201017076 (substantial similarity to Notice 95-34), Field Service Advice 200218014 (substantial similarity to Notice 2001-16), Chief Counsel Advice 200712044 (substantial similarity to Notice 2005-13), Chief Counsel Advice 200929005 (substantial similarity to Notice 2004-8).

16 *See, e.g.*, *Polowniak v. Commissioner*, T.C. Memo 2016-31 (substantial similarity to Notice 2004-8), *Blak Investments et al. v. Commissioner*, 133 T.C. 431 (2009) (substantial similarity to Notice 2000-44), *Our Country Home Enterprises, Inc. v. Commissioner*, 145 T.C. 1 (2015) (substantial similarity to Notice 2007-83); *Turnham v. United States*, 123 AFTR 2d 2019-2042 (D.C. Alabama 2019) (substantial similarity to Notice 95-34), and *Interior Glass Systems, Inc. v. United States*, 123 AFTR 2d 2019-XXXX (9th Cir. 2019) (substantial similarity to Notice 2007-83).

17 Treas. Reg. § 1.6011-4(e)(1).

18 Section 6707A(a), (b); Treas. Reg. § 301.6707A-1(a).

19 Section 6707A(b)(2); Treas. Reg. § 301.6707A-1(a). The minimum penalty is $5,000 for individuals and $10,000 for entities. *See* Section 6707A(b)(3); Treas. Reg. § 301.6707A-1(a).

20 *See* Sections 6671 through 6720B.

21 The IRS's internal guidance confirms this, stating that "[d]eficiency procedures under Subchapter B of Chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) do *not* apply to penalties discussed in this section." I.R.M. § 20.1.9.2 (04-22-11); I.R.M. Exhibit 20.1.9-4; For details about collection freezes and the right to post-assessment, pre-

Disclosure-Related Penalties

Participants in reportable transactions who fail to file timely, complete, and accurate Forms 8886 face penalties equal to 75 percent of the tax savings resulting from their participation.[18] In the case of so-called "listed transactions," the maximum penalty for individual taxpayers is $100,000, while the maximum for entities is $200,000.[19]

Importantly, Form 8886 penalties fall into the category of "assessable penalties."[20] This means that, unlike penalties related to tax liabilities, taxpayers effectively get no opportunity to challenge Form 8886 penalties *before* they are "assessed." The IRS, in its sole discretion, assesses Form 8886 penalties, treats them as a debt, starts taking collection actions, and lacks authority to later rescind or abate penalties involving listed transactions.[21] Thus, if the IRS assesses Form 8886 penalties involving a listed transaction, then participants generally cannot fight them as they could other penalties, by filing a Protest Letter and addressing matters with the Appeals Office and/or by filing a Petition with the Tax Court. Rather, they must dispute the penalties through the collection process or by paying the penalties, filing a Claim for Refund, and, if necessary, launching a Suit for Refund in federal court.[22]

Income-Related Penalties

The IRS can penalize taxpayers engaging in reportable transactions in others ways, too. In particular, if a taxpayer participates in a transaction, and the IRS later disallows the benefits claimed, then the IRS can assess a penalty under Section 6662A equal to 20 percent of the tax increase. ("Reportable Transaction Penalty").[23]

Extended Assessment Periods

In addition to the two types of financial penalties described above, if a participant fails to enclose a Form 8886 with his tax return, then the assessment period with respect to such tax return can remain open a long time. In particular, the period stays open until one year after the earlier of the following two events: The participant finally files Form 8886, or a "material advisor" to the reportable transaction provides the IRS with a list of data about the transaction and its participants in response to a written request.[24]

Form 8275

As explained above, the IRS has utilized for decades *a stick* (in the form of mandatory disclosure requirements, severe penalties, and extended assessment periods) when it comes to reportable transactions and those that are substantially similar. By contrast, the IRS historically has offered a carrot when it comes to positions taken by taxpayers that are merely aggressive or contrary to existing rules.

One way for a taxpayer to dodge certain penalties, including those for disregarding tax rules or for substantially understating the tax due on a particular return, is to bring matters to the IRS's attention pro-actively.[25] Specifically, as long as a situation does not implicate a "tax shelter," a taxpayer normally can escape income-related penalties if he (i) properly discloses his position to the IRS, (ii) has a reasonable basis for the position, and (iii) maintains adequate books, records and other support for the position.[26]

A taxpayer makes a disclosure to the IRS in this context by enclosing a Form 8275 or Form 8275-R (Regulation Disclosure Statement) with the relevant tax return.[27] When it comes to substantial understatement sanctions, the IRS can issue an annual Revenue Procedure or otherwise describe the circumstances under which disclosure on a tax return, alone, is adequate. Barring such guidance from the IRS, disclosure is sufficient only if the taxpayer attaches a completed Form 8275 or Form 8275-R, as appropriate, to his tax return.[28] Congress believed that this disclosure exception to penalties would facilitate taxpayers making good-faith challenges to existing rules.[29]

Relevance to Conservation Easements

In December 2016, the IRS announced in Notice 2017-10 that it intended to challenge what it coined SCETs because they supposedly constituted "tax-avoidance transactions" involving overvaluations of donations.[30] The effect of Notice 2017-10 was to make SCETs listed transactions, which is one subset of reportable

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payment review, *see* I.R.M § 21.8.2.20.2 (10-01-2013); Section 6707A(d)(1).

22 *See, e.g.*, *Barzillai v. United States*, 137 Fed Cl. 788, 121 AFTR 2d 2018-1582 (April 30, 2018); *Larson v. United States*, 888 F.3d 578, 121 AFTR 2d 2018-1598 (April 25, 2018).

23 Section 6662A(a). This penalty increases from 20 percent to 30 percent if the participant fails to file a Form 8886. *See* Section 6662A(c).

24 Section 6501(c)(10); *See also* Treas. Reg. § 301.6501(c)-1(g)(7) (emphasis added); *See also* Treas. Reg. § 301.6501(c)-1(g)(8) (Example 14).

25 In this context, the term "rules or regulations" includes tax provisions in the Internal Revenue Code, temporary or final regulations, Revenue Rulings, and IRS Notices. *See* Treas. Reg. § 1.6662-3(b)(2).

26 Section 6662(d)(2)(B)(ii); Treas. Reg. § 1.6662-3(c); Treas. Reg. § 1.6662-4(e); Treas. Reg. § 1.6662-4(f). The term "tax shelter" means a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement a "significant purpose" of which is to avoid or evade federal income tax. *See* Section 6662(d)(2)(C)(ii); Treas. Reg. § 1.6662-4(g)(2).

27 Treas. Reg. § 1.6662-4(f)(1); Treas. Reg. § 1.6662-4(f)(2); Rev. Proc. 2008-14.

28 Treas. Reg. § 1.6662-4(f)(2); *See* Rev. Proc. 2008-14.

29 U.S. House of Representatives, Committee on the Budget. Omnibus Budget Reconciliation Act of 1989, Report 101-247, 101st Congress, 1st Session (Sept. 20, 1989), pg. 1393.

30 Notice 2017-10, Preamble and Section 1.

31 Section 6707A(c)(2); Treas. Reg. § 1.6011-4(b)(2).

32 Participants are allowed to file a "protective" if they are uncertain as to whether a particular transaction is considered an SCET. *See* Treas. Reg. § 1.6011-4(f)(2).

33 Notice 2017-10, Section 3.

34 U.S. House of Representatives, Committee on the Budget. The Reconciliation Act of 2010. 111th Congress, 2nd Session, Report 111-443, Volume I, Division I, March 17, 2010, pg. 295.

35 Health Care and Education Reconciliation Act of 2010, Public Law No. 111-152 (March 31, 2010).

36 Section 7701(o)(1); Section 7701(o)(5)(D).

37 In the case of individual taxpayers, the two-part economic substance test applies only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income. *See* Section 7701(o)(5)(B).

38 Section 6662(b)(6).

39 Section 6662(i).

40 Section 6664(c)(2).

41 U.S. House of Representatives, Committee on the Budget. The Reconciliation Act of 2010. 111th Congress, 2nd Session, Report 111-443, Volume I, Division I, March 17, 2010, pg. 304.

42 Notice 2010-62 (Sept. 13, 2010).

43 *Id.*

44 Internal Revenue Service. Policy Statement on the Tax Regulatory Process. March 8, 2019.

transactions.[31] Notice 2017-10 required taxpayers who participate in SCETs or substantially similar transactions to file Form 8886.[32] Participants include the partnerships that own the land and donate the easements, affiliated partnerships in situations involving multi-tier structures, investor-partners to whom the tax deductions from conservation easement donations eventually flow, and other persons whose tax returns reflect the tax consequences or tax strategies.[33]

Most participants in SCETs presumably filed Forms 8886, but many might not have submitted Forms 8275 or Forms 8275-R for several reasons. First, participants believed that the SCETs were adequately disclosed to the IRS in *multiple* ways, including, but not limited to, (i) the partnership expressly claiming the deduction on its Form 1065 (U.S. Return of Partnership Income), (ii) the partnership enclosing a Form 8283 (Noncash Charitable Contributions), Form 8886, and appraisal with its Form 1065, (iii) the partnership and others filing Forms 8918 (Material Advisor Disclosure Statement), (iv) the investor-partners claiming their portions of the deductions on their Forms 1040 and enclosing Forms 8886, and (v) the partnership and investor-partners submitting copies of Forms 8886 to the Office of Tax Shelter Analysis. Second, participants thought that SCETs were entirely consistent with legislative history, the key tax provision (i.e., Section 170(h)), tax regulations, IRS rulings, court cases, and other authorities. Third, participants understood that the economic substance doctrine did not apply in the context of congressional tax inducements, such as easement-related deductions under Section 170(h), and even if it did, the partnerships met the economic substance standards.

APA Violations with Income-Related Penalties

It has come to light recently that the IRS violated the APA in two significant ways. The first is that the IRS improperly required participants in reportable transactions to file both Form 8886 and Form 8275 in order to prevent the IRS from asserting an income-related penalty.

Congress enacts tax laws, and the IRS issues regulations and other forms of administrative guidance to implement them. The government is replete with tax experts, but even they cannot foresee everything when they are formulating tax rules. Accordingly, some courts find it necessary to supplement the law in an effort to deter "unintended consequences."[34] The courts do so by creating various judicial mechanisms, among them the economic substance doctrine. The economic substance doctrine remained solely an invention of the courts for many years. Things changed in 2010, though, when Congress "codified" it.[35] That meant Congress transformed it from a theory created and applied by the courts into a specific provision in the Internal Revenue Code. Section 7701(o) provides that, in the case of a transaction to which the economic substance doctrine applies, such transaction shall be treated as having economic substance if, and only if, (i) the transaction changes the taxpayer's economic position "in a meaningful way," apart from federal income tax effects, *and* (ii) the taxpayer has a "substantial purpose" for engaging in the transaction, apart from federal income tax effects.[36] A transaction must meet both tests if the taxpayer wants to obtain the tax benefits.[37]

The IRS can assert a penalty equal to 20 percent of the tax liability where such liability results from the disallowance of a tax benefit because the relevant transaction lacked economic substance.[38] The penalty increases to 40 percent in cases where a taxpayer did not adequately disclose to the IRS his participation in the transaction on the relevant tax return or in a statement attached thereto ("Undisclosed-Non-Economic-Substance-Transaction Penalty").[39]

In many situations, a taxpayer can avoid penalties by demonstrating that he had "reasonable cause" for a tax understatement and he acted in "good faith." A taxpayer *cannot* use such justifications to ward off economic substance penalties, though.[40] The legislative history refers to this as a "strict liability penalty," and the fact that a taxpayer acquires a legal opinion before engaging in a transaction will not protect him from penalties, if the transaction ultimately fails the economic substance test.[41]

Expanded Disclosure Duties under Notice 2010-62

The IRS issued some "interim guidance" about Section 7701(o) and the related penalties about six months after Congress enacted the law in 2010. Such guidance came in the form of Notice 2010-62.

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[45] Chief Counsel Advisory 202244010 (Nov. 4, 2022); "Microcaptive Transactions Are Adequately Disclosed on Form 8886," 2022 Tax Notes Today Federal 214-21 (Oct. 3, 2022).

[46] Notice 2010-62 (Sept. 13, 2010).

[47] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5 (2022).

[48] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 7 (2022) (emphasis added).

[49] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pgs. 7-8 (2022).

[50] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 9 (2022).

[51] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pgs. 9-10 (2022) (internal citations omitted).

[52] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pgs. 10-15 (2022).

[53] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 15 (2022).

[54] *Id.*

[55] Section 6707A(a); Section 6707A(c)(2).

[56] Section 6011(a).

[57] Treas. Reg. § 1.6011-4(a) and (b)(2).

[58] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 16 (2022).

[59] *Id.*

[60] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 17 (2022).

[61] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 16 (2022).

[62] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 19 (2022) (emphasis added).

[63] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 19 (2022).

[64] *Id.*

[65] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 21 (2022).

[66] *Id.*

[67] *Id.*

[68] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 12 (2022) (quoting from *Mann Construction, Inc. v. United States*, 539 F. Supp. D 745 (E.D. Mich. 2021)).

[69] U.S. Senate, Committee on Finance. Syndicated Conservation Easement Transactions, 116th Cong., 2nd Session, Senate Report 116-44 (August 2020), pg. 105.

[70] U.S. Senate, Committee on Finance. Syndicated Conservation Easement Transactions, 116th Cong., 2nd Session, Senate Report 116-44 (August 2020), pgs. 4 and 105.

Among other things, the IRS provided clarity regarding disclosure levels and methods. Expanding on the standards initially set, Notice 2010-62 indicated that a transaction lacking economic substance would *only* be considered adequately disclosed if a taxpayer were to report it on a Form 8275 or Form 8275-R, as appropriate.[42] It further explained that, if a transaction not only lacked economic substance but also constituted a reportable transaction, then taxpayers must file *both* a Form 8275 or Form 8275-R *and* a Form 8886 to meet the disclosure standard.[43] In other words, Notice 2010-62 indicated that the only way to avoid imposition of the Undisclosed-Non-Economic-Substance-Transaction Penalty, equal to 40 percent of the tax liability, was to file *multiple* disclosures.

IRS Policy Statement

Nearly a decade after issuing Notice 2010-62, the IRS published a Policy Statement on the Tax Regulatory Process ("Policy Statement") in 2019.[44] The IRS thereby declared its commitment to a regulatory process that encourages public participation, features transparency, offers fair notice, and follows the law. The IRS acknowledged in the Policy Statement that the "best practice" for rulemaking by agencies, like the IRS, is to adhere to the notice-and-comment procedure established by Congress in the APA. The Policy Statement covered various topics, among them the appropriate use by the IRS of so-called "Subregulatory Guidance." The IRS defines this term to encompass Revenue Rulings, Announcements and Notices, all of which fall *below* regulations in the hierarchy of tax authorities. The Policy Statement indicated that "sound tax administration" sometimes necessitates the use of "less formal guidance" to efficiently advise the public about certain matters. For instance, Subregulatory Guidance supplies taxpayers "much-needed clarity and certainty concerning the legal interpretation that the IRS intends to apply."

The Policy Statement underscored the importance of restraint, though. It explained that the IRS *cannot* use Subregulatory Guidance to modify existing law or to create new law. In this regard, the Policy Statement assured taxpayers that the IRS "will not argue that Subregulatory Guidance has the force and effect of law." The Policy Statement also confirmed that the IRS would issue Subregulatory Guidance in limited circumstances. Specifically, the IRS would utilize Subregulatory Guidance only in situations where it was providing an interpretation of existing law as applied to a particular set of facts, a type of relief derived from a tax provision, a statement of IRS practice or procedure, an announcement of forthcoming proposed regulations, or information that merely has immediate or short-term value.

New IRS Guidance in 2022

The IRS identified its own shortcomings, and perhaps anticipated its looming legal problems, when it issued Chief Counsel Advisory 202244010 ("CCA") in late 2022. The question presented in the CCA was whether revealing participation in a micro-captive insurance transaction only on Form 8886, and not also on a separate Form 8275, was enough to prevent the IRS from imposing the Undisclosed-Non-Economic-Substance-Transaction Penalty.[45]

The IRS summarized in the CCA the disclosure rules applicable to transactions that might lack economic substance. The IRS then acknowledged that it never promulgated *regulations* under the relevant provision, issuing instead Notice 2010-62, which is Subregulatory Guidance. As explained above, Notice 2010-62 mandated that if a transaction not only lacked economic substance but also constituted a reportable transaction, then taxpayers must file *both* a Form 8275 and Form 8886 to meet the disclosure standard.[46]

More than a decade had passed since Notice 2010-62 appeared, and time seems to have changed the IRS's perspective. The CCA warned that the IRS cannot contend now that Notice 2010-62 requires taxpayers to file a Form 8275 because doing so would conflict with the more recent Policy Statement. As mentioned earlier, the Policy Statement prohibits the IRS from arguing that Subregulatory Guidance, such as Notice 2010-62, has the force and effect of law. The CCA then underscored that neither the Internal Revenue Code nor the corresponding regulations requires taxpayers to file Forms 8275 (in addition to Forms 8886) to avoid the Undisclosed-Non-Economic-Substance-Transaction Penalty; that duty derives *solely* from Notice 2010-62. Accordingly, the IRS must rely strictly on the express language in the relevant provision, Section 6662(i)(2), and case law to determine when disclosure is adequate. Based on these two sources, the IRS concluded as follows in the CCA:

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[71] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 22 (2022).

[72] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pgs. 22-23 (2022).

[73] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 23 (2022).

[74] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, pg. 23(2022) (emphasis added).

[75] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, footnote 5 and 22 (2022).

[76] Section 6110(k)(3); Section 6110(b)(1)(A); Section 7463(b); *Nico v. Commissioner,* 67 T.C. 647, 654 (1977) (stating that "we consider neither Revenue Rulings nor Memorandum Opinions of this Court to be controlling precedent"); *Huffman v. Commissioner*, 126 TC 322, 350 (confirming that "memorandum opinions are not binding"); James S. Halpern, "What Has the Tax Court Been Doing?" An Updated, Tax Notes 1277 (May 30, 2016) (explaining that the "official position of the Tax Court appears to be that, with respect to memorandum opinions, we are not bound by the doctrine of stare decisis").

[77] *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5, footnote 22 (2022) (emphasis added).

[78] *CIC Services, LLC v. Internal Revenue Service*, 129 AFTR 2d 2022-1119 (DC TN 2022).

[79] *Mann Construction, Inc. v. United States*, 27 F. 4th 1138 (6th Cir. 2022).

[80] *Liberty Global, Inc. v. United States*, 129 AFTR 2d 2022-1373 (DC CO 2022).

[81] "Government Concedes in Conservation Easement Reporting Notice Case," 2022 Tax Notes Today Federal 100-23 (May 20, 2022).

[82] *GBX Associates, LLC v. United States*, Case No. 1:22cv401, Memorandum Opinion & Order, District Court Ohio, Nov. 14, 2022.

[83] *See Glade Creek Partner, LLC v. Commissioner*, T.C. Memo 2020-148; *Glade Creek Partner, LLC v. Commissioner*, 130 AFTR 2d 2022-5625 (11th Cir. 2022); *Champions Retreat Golf Founders, LLC v. Commissioner*, T.C. Memo 2018-146; *Champions Retreat Golf Founders, LLC v. Commissioner*, 959 F.3d 1033 (11th Cir. 2020); *Champions Retreat Golf Founders, LLC v. Commissioner*, T.C. Memo 2022-106; Hale E. Sheppard, "Reasonable IRS Appraisal Triggers Conservation Easement Settlement," 174(1) Tax Notes Federal 55 (2022).

[84] *Powell v. United States*, 379 U.S. 48, 57-58 (1964).

> [W]here Form 8886 is timely filed with a return or a qualified amended return and provides a complete description of the relevant facts of a noneconomic substance transaction, taxpayers *have a strong argument* that they have adequately informed the IRS of the transaction consistent with the requirements of Section 6662(i). In contrast, Forms 8886 that are deficient or omit material facts regarding the transaction can be argued to fall short of the disclosure required by Section 6662(i).

APA Violations with Disclosure-Related Penalties

All eyes have recently focused on *Green Valley Investors*, a consolidated Tax Court case centered on four conservation easement donations generating a total of approximately $90 million in tax deductions.[47] The donations in this case occurred in 2014 and 2015, several years *before* the IRS issued Notice 2017-10 labeling SCETs as "listed transactions," imposing Form 8886 filing duties, and more. The IRS audited and, predictably, took the position that the partnerships were entitled to $0 in deductions because they supposedly failed to satisfy all technical requirements. Moreover, the IRS claimed that the partnerships deserved various sanctions.

The partnerships disagreed with the IRS's stance and filed Petitions with the Tax Court. The IRS then upped the ante, so to speak, by asserting in its Answers to the Petitions that the partnerships should face the Reportable Transaction Penalty under Section 6662A because the tax understatements related to reportable transactions, i.e., SCETs.

Pre-trial battles ensued. These manifested as multiple Cross-Motions for Summary Judgment filed by the parties on assorted issues, including whether the IRS could assert a Reportable Transaction Penalty in the first place.

Issue Left Unaddressed by Tax Court

The partnerships first argued that the IRS could not hit them with the Reportable Transaction Penalty under Section 6662A because, well, conservation easement donations were *not* "listed transactions" in 2014 and 2015, when theirs occurred. The IRS did not issue Notice 2017-10 until December 2016; therefore, reasoned the partnerships, imposition of such sanction would be retroactive and inappropriate.

The Tax Court cited a list of cases for the notion that it had "previously upheld the retroactive application of penalties, *even though* the taxpayers became subject to the penalties *after* they had entered into the transaction or *after* their tax returns had been filed."[48] However, because it held in favor of the partnerships in this case on other legal grounds, discussed below, the Tax Court refrained from opining on whether the IRS can assert a Reportable Transaction Penalty retroactively.

Analysis of Critical Issue

The Tax Court then turned to the key issue, whether the IRS violated the APA in issuing Notice 2017-10, such that it was invalid from the outset. The Tax Court filled nearly 40 pages with its analysis, including concurrences and dissents. This article focuses on the main points.

The Tax Court explained that the APA involves a three-step procedure, dictating that agencies, like the IRS, must (i) issue a general notice to the public about proposed rulemaking, (ii) allow interested persons to provide input, by submitting comments and participating in hearings, and (iii) feature in the final rule a "concise general statement" of its "basis and purpose." The Tax Court then acknowledged the existence of certain exceptions, including that the APA does not apply to "interpretive rules." Finally, the Tax Court recognized that Congress reserved the right to modify the APA requirements, but warned that a statue enacted later cannot be interpreted as modifying or superseding the APA unless "it does so *expressly.*"[49]

First Argument by the IRS

The IRS raised a couple arguments, the first of which was that Notice 2017-10 supposedly constitutes an "interpretive rule," not a "legislative rule," so it is not covered by the APA.

The Tax Court began by defining legislative rules as those that impose new rights or duties and change the legal status of parties. By contrast, interpretive rules simply inform the public of the interpretation by an agency, like the IRS, of a statute that it is in charge of administering. The Tax Court quickly determined that Notice 2017-10 is a legislative rule for two reasons. First, the Sixth Circuit Court of Appeals held just last year, in 2021, that a similar Notice issued by the IRS, labeling certain trust arrangements as listed transactions, was a legislative rule.[50]Second, after citing the particular statutes in which Congress empowered the IRS to create rules about filing returns and identifying reportable transactions, the Tax Court offered the following broad conclusion:

> The act of identifying a transaction as a listed transaction by the IRS, by its very nature, is the creation of a substantive (*i.e.,* legislative) rule and not merely an interpretive rule. Identifying a transaction as a listed transaction does not merely provide the IRS's interpretation of the law or remind taxpayers of pre-existing duties. Rather, as we will detail below, identifying a transaction as a listed transaction imposes new duties in the form of reporting obligations and record-keeping requirements on both taxpayers and their advisors. Notice 2017-10 exposes these individuals to additional reporting obligations and penalties to which they would not otherwise be exposed but for the Notice. Creating new substantive duties and exposing taxpayers to penalties for non-compliance "are hallmarks of a legislative, not interpretive, rule."[51]

The Tax Court then devoted several pages to specifying the long list of filing and record-keeping duties that Notice 2017-10 imposed on both "participants" in, and "material advisors" to, SCETs. The Tax Court also highlighted the potential penalties for violations.[52] It then wrapped up its thoughts on the matter as follows:

> In sum, by its issuance, Notice 2017-10 creates new substantive reporting obligations for taxpayers and materials advisors, including [the partnerships in *Green Valley Investors*], the violations of which prompts exposure to financial penalties and sanctions – the prototype of a legislative rule. We cannot see how Notice 2017-10 could

> be considered an interpretive rule; consequently, we find it to be a legislative rule.[53]

Because Notice 2017-10 is a legislative rule, with the force and effect of law, the Tax Court clarified that it was subject to the general three-step procedure created by the APA.[54]

Second Argument by the IRS

Down but not out completely, the IRS took another approach. It argued that *after* enacting the APA, Congress *later exempted* the IRS from complying with it when it passed Section 6707A, the provision allowing the IRS to penalize taxpayers for not filing Forms 8886. Understanding the IRS's argument requires a step back. Section 6707A generally states that the IRS can penalize any person who fails to file Form 8886 to disclose a reportable transaction, as required and defined by Section 6011.[55] For its part, Section 6011 explains that all persons liable for any tax shall file a return or statement "according to the forms and regulations" issued by the IRS.[56] Finally, the regulations under Section 6011 require taxpayers who participated in a reportable transaction identified by the IRS "by notice, regulation, or other form of published guidance" to file Form 8886.[57]

The Tax Court added to that foundation. It first emphasized that the APA specifically states that a subsequent statue cannot be interpreted to modify or supersede the APA "except to the extent that it does so *expressly.*" The Tax Court also underscored that various Courts of Appeal have previously held that the express-statement mandate in the APA acts to prohibit later "amendment by implication."[58] It then observed that the Supreme Court has established a "powerful presumption against implied repeal" of existing laws, such as the APA.[59]Finally, the Tax Court referenced various cases for the proposition that "mere differences between a [later] statutory scheme and the APA are insufficient to establish Congress' intent to dispense with the standard APA procedures."[60]

The Tax Court then turned to the IRS's contention that Congress said it was free to ignore the APA when it comes to listed transactions. The Tax Court framed the issue in the following manner: "[T]he remaining question before us is whether Congress has established [post-APA] procedures so different from those required by the APA that it intended to displace the norm."[61] The Tax Court started by parsing the two provisions cited by the IRS, Section 6011 and Section 6707A. The Tax Court observed that the former is "silent on any *express* congressional intent" and the latter "offers no *express* indication from Congress of exempting the IRS from the standard notice-and-comment rulemaking of the APA."[62] After analyzing some relevant cases, the Tax Court held that neither of the two tax provisions "says anything that would lead us to conclude that the IRS is exempt from the baseline procedures for rulemaking under the APA."[63]

The IRS then emphasized an ordering issue. Congress first enacted Section 6011. The IRS then issued regulations stating that taxpayers who participated in a transaction identified by the IRS in a "notice, regulation, or other form of published guidance" must file Form 8886. Later, Congress passed Section 6707A. The IRS suggested that the intermediary regulation adequately apprised Congress that it planned to operate outside the APA requirements, by issuing Notice 2017-10 without previous warning or opportunity for public comment. The Tax Court was "not persuaded." It was skeptical that Congress understood that the IRS's reference to "notice" in the regulations constituted a particular procedure for identifying listed transactions that was separate from the longstanding APA three-step process. The Tax Court punctuated, again, that "Congress operates under the expectation that administrative agencies [like the IRS] respect the APA obligations except when Congress expressly chooses different procedures."[64] More importantly, the Tax Court stressed that its job was to determine *whether Congress* in enacting statutes, *not the IRS* in issuing regulations, changed the traditional applicability of the APA in the context of listed transactions.[65] The Tax Court aired its limits:

> We acknowledge that Congress understood that the IRS had identified listed transactions before enactment of [Section 6707A]. We also recognize that Congress, through its enactment of [Section 6707A], was acknowledging the IRS's disclosure framework already in place [under Section 6011] with the goal of strengthening its efficacy. But, we *cannot accept* that the enactment of [Section 6707A] as Congress*' blanket approval* of the IRS's method of identifying a syndicated conservation easement as a listed transaction in Notice 2017-10 without *notice and comment.*[66]

The IRS tried another argument, again without success. The IRS pointed out that Congress has amended Section 6707A several times since its original enactment in order to increase penalty amounts. The IRS suggested that, at the time of the amendments, Congress presumably was aware of how the IRS was interpreting Section 6707A and identifying listed transactions, such that it could have done something about it if it disapproved. The Tax Court countered that Congress was "equally aware of the normal APA rulemaking requirements, which it must 'expressly' override."[67] Referring to a recent decision by the Sixth Circuit Court of Appeals on an analogous issue, the Tax Court observed that subsequent inaction might, but does not always, mean tacit agreement by Congress with IRS behavior. The Tax Court further stated that congressional silence "rarely suffices to show express modification of the APA's bedrock procedural guarantees given the raft of potential explanations for inaction on Capitol Hill."[68]

The Senate Finance Committee conducted an inquiry and issued a report in 2020, suggesting that SCETs were "abusive tax shelters."[69] The report, however, did not offer any specific recommendations about how to address perceived problems, and it underscored that the deduction for conservation easement donations should remain.[70]

In what appears to be something akin to a legal Hail Mary, the IRS suggested that the investigation by the Senate Finance Committee constituted "persuasive evidence that Congress intended to override the APA's applicability to the IRS's listing of transactions."[71] The Tax Court

politely, but swiftly, rejected this argument. It explained that congressional oversight hearings, written statements by chairs of the Senate Finance Committee, and testimony by members of the Executive Branch do not reach the level of "express congressional intent" that would override the need for the IRS to comply with the APA in issuing Notice 2017-10.[72] The Tax Court added that such "congressional actions alone are insufficient to supplant the APA since the Supreme Court has told us exemptions from the terms of the APA are not presumed and must be expressed by Congress."[73]

Tax Court Rulings, Narrow and Broad

Based on the preceding analysis, the Tax Court declared itself "unconvinced that Congress *expressly* authorized the IRS to identify a syndicated conservation easement transaction as a listed transaction without the APA's notice-and-comment procedures, as it did in Notice 2017-10."[74] Thus, when it comes to the taxpayers in *Green Valley Investors,* the result is that the IRS cannot assert the Reportable Transaction Penalty under Section 6662A.[75]

The ruling will have much wider applicability, though. Tax procedure junkies will appreciate that the Tax Court issues three main types of decisions, namely, T.C. Opinions, T.C. Memorandum Opinions, and T.C. Summary Opinions. Only the first type, called a "published" opinion, generally constitutes binding precedent for Tax Court purposes.[76] The Tax Court ensured that *Green Valley Investors* would be authoritative for other taxpayers by issuing it as a T.C. Opinion. Lest anyone be confused about its importance and scope, the Tax Court expressly stated that it "intends to apply this decision setting aside Notice 2017-10 *to the benefit of all similarly situated taxpayers who come before us.*"[77]

Conclusion

The IRS likely will attempt to downplay the importance of *Green Valley Investors,* arguing that it affects just one potential penalty of many, does not prevent the IRS from continuing its compliance campaign against easements, etc. That sort of bravado seems a little strained at this point, though. Why?

Green Valley Investors represents just the latest in a growing list of APA-related problems for the IRS. For example, a District Court held that the IRS violated the APA when it issued Notice 2016-66 identifying certain micro-captive insurance arrangements as "transactions of interest."[78] Likewise, the Sixth Circuit Court of Appeals ruled that the IRS improperly ignored the APA when it published Notice 2007-83 calling trusts using cash life insurance policies listed transactions.[79] Another District Court determined that the IRS failed to comply with the APA in issuing temporary regulations for the dividends-received-deduction under Section 245A.[80]Moreover, the government filed an Answer in a pending District Court case admitting, for certain purposes, that Notice 2017-10 is a legislative rule, the IRS did not follow the notice-and-comment procedures, and the IRS was not exempt from the procedures, such that Notice 2017-10 is invalid.[81] The District Court later agreed, declaring Notice 2017-10 "unlawful" and setting it aside, but only with respect to the particular taxpayer in that case.[82] Finally, the IRS issued the CCA indicating that the IRS cannot argue that taxpayers must file both Forms 8275 and Forms 8886 to avoid the Undisclosed-Non-Economic-Substance-Transaction Penalty because the sole source of this double duty, Notice 2010-62, contravenes the APA and the IRS's own Policy Statement.

In addition to the series of APA-related losses described above, the IRS has been hit recently with decisions by the Tax Court and Eleventh Circuit Court of Appeals approving easement valuation methodologies used by partnerships, a District Court case ruling that the economic substance doctrine is inapplicable to congressional tax inducements, and various partnerships ending up with at least 75 percent of the tax deductions they originally claimed.[83]

Finally, although the decision in *Green Valley Investors* only addresses the Reportable Transaction Penalty on the surface, it could have other implications and trigger many questions. Here are merely a few. Will the IRS elevate the issue to the pertinent Court of Appeals? Will the decision trigger a slew of other APA disputes in other contexts? Will the IRS's ability to readily identify and attack easement donations diminish, if participants decide to cease filing Forms 8886 and material advisors do the same with Forms 8918? Will the IRS be flooded with Claims for Refund for penalties previously paid for alleged Form 8886 and Form 8918 violations? Must the IRS return to the relevant parties all materials that it gathered during audits and litigation based on invalid Notice 2017-10? Will the IRS be unable to challenge certain easement transactions because it can no longer rely on extended assessment periods for unfiled Forms 8886? Will courts agree to shift the burden-of-proof to the IRS during litigation on grounds that its positions, at least as they pertain to Notice 2017-10, were "arbitrary and capricious?" Will courts refuse to enforce Summonses issued by the IRS because its examinations lack a legitimate purpose, according to the Supreme Court standards?[84]

Those involved with conservation easement disputes, as well as others associated with any type of reportable transaction, will be following the effects of *Green Valley Investors* in the future. ●