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Tax Practice Tip

Making "Qualified Offers" in Partnership Disputes: Extreme Positions by IRS in Conservation Easement Cases Might Backfire

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I. Introduction

There were times, in the past, when the IRS was straightforward with taxpayers, describing in its notices the issues that it was attacking and the specific facts and theories on which it was asserting taxes, penalties, and interest. This permitted taxpayers to understand where they stood with the IRS, the precise areas of disagreement, and what had to be done to achieve an acceptable resolution, hopefully before the need for protracted, expensive, and uncertain Tax Court litigation.

The IRS does not follow that procedure any longer, at least when it comes to conservation easement donations by partnerships. The standard approach by the IRS now is to fully disallow easement-related tax deductions based on several "technical" arguments under Code Sec. 170, and then, as a backup, fully disallow the deductions for supposed valuation problems. In other words, regardless of the quality of the transaction and/or the degree of due diligence behind it, the IRS ordinarily floats several theories, on technical and valuation grounds, to claim that the partnership merits a tax deduction of $0, plus the highest possible penalty because of a "gross valuation misstatement."

A traditional manner of stopping such extreme behavior by the IRS has been for taxpayers to make a "qualified offer" to settle. If the IRS ignored or rejected the qualified offer, the case went to trial, and the court ruled that the taxpayer's liability was the same as or less than the amount of the earlier qualified offer, then the taxpayer generally could recoup reasonable fees and costs from the IRS. Two recent cases address whether partnerships can make a "qualified offer," and the only one with precedential value determined that, yes, they can.

This article analyzes the standards for obtaining fee and cost recoupment from the IRS, the cases applying the qualified offer rule to partnerships, the main aspects of a conservation easement donation dispute, current practices by the IRS, and the fact that the IRS might see its damn-the-torpedoes strategy backfire.

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II. Recouping Costs from the Government

Generally, Code Sec. 7430 provides that the "prevailing party" in any administrative proceeding before the IRS, or in any litigation that is brought by or against the government in connection with the determination, collection, or refund of any tax, penalty, or interest may be awarded reasonable administrative and/or litigation costs.[1] Recoverable administrative costs may include legal fees, reasonable expenses for expert witnesses, and costs for any study, analysis, report, test, or project necessary for the preparation of the taxpayer's case.[2] Litigation costs for which the taxpayer may seek reimbursement follow similar guidelines.[3] Various aspects about recovery pursuant to Code Sec. 7430 are explained below.

A. Prevailing Party Standards

The term "prevailing party" generally means a party in any tax-related administrative proceeding or litigation that (i) has substantially prevailed with respect to either the amount in controversy or the most significant issues presented, and (ii) has a net worth that does not exceed the statutory thresholds.[4]

In cases involving partnerships that are subject to the special partnership-level proceedings created by the Tax Equity and Fiscal Responsibility Act ("TEFRA"), a partnership meets the net worth and size limitation standards if, on the day of the administrative proceeding, the partnership's net worth is not more than $7 million, the partnership does not have more than 500 employees, and each partner requesting reimbursement also meets the corresponding net worth and size limitations.[5] Notably, in calculating a taxpayer's net worth for these purposes, the IRS uses a taxpayer-friendly approach, measuring the acquisition cost of assets, not their current fair market value (FMV).[6]

B. Exhausting Administrative Remedies

Even if a taxpayer substantially prevails and meets the net worth requirement, the taxpayer still cannot recover costs from the government, unless other hurdles are overcome. For example, the taxpayer must have exhausted all administrative remedies available within the IRS.[7] This mandate does not obligate the taxpayer to grant the IRS extensions of the assessment-period.[8] However, in a Chief Counsel Advice noteworthy for its muddled reasoning, the IRS indicated that taxpayers must always exhaust administrative remedies, regardless of whether they are seeking cost recoupment under a "prevailing party" or "qualified offer" theory:

> If appeal rights are given prior to the [statutory notice of deficiency] then the [taxpayer] must request a conference with Appeals prior to filing a petition with the tax court to exhaust administrative remedies. If for varying reasons the [taxpayer] is not given appeal rights prior to the [statutory notice of deficiency] then the [taxpayer] is excused from exhausting administrative remedies prior to petitioning the tax court. However, if after filing a petition with the tax court counsel refers the case to Appeals or gives the [taxpayer] the opportunity to go to Appeals then the [taxpayer] must participate in an Appeals conference to exhaust administrative remedies. Exhaustion of administrative remedies is a requirement to recover costs under [Code Sec.] 7430. Exhaustion is not a requirement to make a qualified offer although the [taxpayer] may not recover costs pursuant to the qualified offer rule unless the [taxpayer] has exhausted administrative remedies. So in reality exhaustion is a requirement although technically it is not.[9]

C. No Unreasonable Delays by Taxpayer

To preserve eligibility for fee recoupment, the taxpayer cannot "unreasonably protract" the proceedings with the government.[10]

D. Substantial Justification for Government Positions

The taxpayer will not be deemed the "prevailing party" if the government establishes that its position was "substantially justified."[11] In other words, if the government manages to prove that the position it took during the administrative dispute or litigation was substantially justified, then the taxpayer is precluded from recovering costs. Understanding what constitutes a "substantial justification," therefore, is paramount.

Until 1996, the burden was on the taxpayer to demonstrate that the government's position was *not* substantially justified. This radically changed with the enactment of the Taxpayer Bill of Rights 2, which shifted the onus to the government.[12] According to congressional reports, "the successful taxpayer will receive an award of attorney's fees unless the IRS satisfies its burden of proof."[13] This legislation introduced another major change; it required the IRS to follow its published guidance disseminated to the public, as well as its private guidance provided to particular taxpayers.[14] If it fails to do so, it runs the risk of lacking an acceptable justification for a proposed tax treatment.

Congress further advanced the issue in favor of taxpayers in 1998 with the passage of the Taxpayer Bill of Rights 3.[15] This legislation empowered the courts to take into account whether the government has lost on similar issues in appellate courts for other circuits in determining if its position is substantially justified.[16] The relevant congressional reports reveal the purpose for this increased pressure: Congress was concerned that the IRS would continue to litigate issues that have been previously decided in other circuits.[17] This brand of stubbornness, say the reports, would place an undue burden on those taxpayers forced to dispute decided issues.[18]

The legislative modifications discussed above have been incorporated into the Internal Revenue Code and corresponding regulations. The general rule still stands that a taxpayer will not be considered a "prevailing party," and thus will not be entitled to reimbursement, if the government's position was substantially justified.[19] However, there is now a rebuttable presumption that the government's position is *not* substantially justified, if it failed to follow its "applicable published guidance" during a proceeding.[20] Such guidance includes regulations (final or temporary), revenue rulings, information releases, notices, and announcements.[21] It also encompasses various items issued to the particular taxpayer involved in a dispute, such as private letter rulings, technical advice memoranda, and determination letters.[22] In deciding whether the position taken by the government was substantially justified, the courts are instructed to consider whether the government lost on similar issues in federal appeals courts.[23]

The regulations provide additional clarity regarding what constitutes a substantial justification. For instance, they explain that the government's position is substantially justified only if it has a reasonable basis in both fact and law.[24] A significant factor in making this determination is whether the taxpayer presented all the relevant information under his control to the appropriate IRS personnel.[25] This seems logical because a taxpayer should have little room to complain about the government's position when he fails to provide the information, documentation, and arguments necessary to support his own stance.

Along with the legislative history and the regulations, case law is helpful in identifying what represents substantial justification. Certain courts have developed a framework, a non-exhaustive list of factors to be considered. Among these factors are (i) the stage at which the issue or litigation is resolved, (ii) the opinions of other courts on the same underlying issues, (iii) the legal merits of the government's position, (iv) the clarity of the governing law, (v) the foreseeable length and complexity of the litigation, and (vi) the consistency of the government's position.[26] Other courts have utilized a different approach, scrutinizing whether the position taken by the IRS was reasonable.[27] These courts hold that a position is substantially justified if it is "justified to a reasonable degree that could satisfy a reasonable person or that has a reasonable basis in both law and fact."[28] Still other courts rely on a different test, presenting the question as whether the government knew or should have known that its position was invalid at the time it took it.[29]

III. Effect of Qualified Offers

As explained above, a taxpayer ordinarily will be considered the prevailing party, and thus might be entitled to reimbursement, if the taxpayer substantially prevails with respect to the amount in controversy or the most significant issues, has a net worth below the applicable limit, demonstrates that the government's position was not substantially justified, exhausts all administrative remedies available, and does not unreasonably extend the proceedings.

A. General Rule

There is a lesser known, but often more effective, way of obligating the government to pay: making a so-called "qualified offer." A taxpayer is treated as the prevailing party if the taxpayer's liability (excluding interest), pursuant to a court judgment in the relevant proceeding, is the same as or less than the liability would have been if the government had accepted the qualified offer.[30]

B. Main Exceptions

Caveats exist, of course. The qualified offer rule does not apply, for instance, to a proceeding in which the amount of the tax liability is not an issue, such as court actions to obtain a Declaratory Judgment, enforce or quash a Summons, *etc*.[31]

The qualified offer rule is also inapplicable where the parties settle the case before a court issues its judgment: "A taxpayer cannot qualify as a prevailing party by reason of having made a qualified offer if the determination of the court in the proceeding with respect to the adjustments included in the last qualified offer is entered exclusively pursuant to a settlement."[32] Stated differently, taxpayers can only recoup fees from the government if they make a "qualified offer," the government ignores or rejects such offer, and the case is resolved through litigation, with the court issuing a decision. Thus, making a "qualified offer" might convince the IRS or DOJ to reevaluate the strength of its position and agree to a pre-trial settlement.

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In such circumstances, the taxpayer would enjoy a lower tax liability, but not fee recoupment, too. The regulations contain an example describing this situation:

> Taxpayer D receives a notice of proposed deficiency (30-day letter) proposing to disallow both a personal interest deduction in the amount of $10,000 (Adjustment 1), and a charitable contribution deduction in the amount of $2,000 (Adjustment 2), and to include in income $4,000 of unreported interest income (Adjustment 3). D timely files a protest with Appeals. At the Appeals conference, D presents substantiation for the charitable contribution and presents arguments that the interest paid was deductible mortgage interest and that the interest received was held in trust for Taxpayer E. At the conference, D also provides the Appeals officer assigned to D's case a written offer to settle the case for a deficiency of $2,000, exclusive of interest. The offer states that it is a qualified offer for purposes of Section 7430(g) and that it will remain open for acceptance by the IRS for a period in excess of 90 days. After considering D's substantiation and arguments, the Appeals Officer accepts the $2,000 offer to settle the case in full. Although D's offer is a qualified offer, because all three adjustments contained in the qualified offer were settled, the qualified offer rule is inapplicable.[33]

The regulations also raise another interesting issue, which is what occurs where there is a judicial determination on a substantive tax issue, followed by a related settlement by the parties. This would happen, for instance, where a court grants a Motion for Partial Summary Judgment resolving a legal/tax issued covered by a qualified offer, but leaves open a key matter, such as substantiation or valuation. The Preamble to the regulations provides the following guidance for these types of situations:

> [I]f one or more adjustments covered by a qualified offer are settled following a ruling by the court that substantially resolves those adjustments, then those adjustments will *not* be treated as having been settled prior to the entry of the judgment by the court and *instead* will be treated as amounts included in the judgment as a result of the court's determinations.[34]

The Preamble to the final regulations explains the rationale for the no-fee-recoupment-in-disputes-that-are-settled-between-the-parties rule. It indicates that the qualified offer concept was enacted to encourage settlements and "[r]equiring the government to pay … costs with respect to issues resolved exclusively pursuant to a settlement would be contrary to that goal."[35]

C. Making Multiple Qualified Offers

If a taxpayer makes more than one "qualified offer" during the dispute-resolution process, then the analysis is based on the "last qualified offer," and the bills do not start accumulating against the government until after the date of the "last qualified offer."[36]

D. Criteria for Qualified Offers

This all begs the question of what, exactly, will be considered a qualified offer? Generally, it is a (i) written offer, (ii) made by the taxpayer, (iii) to the government, (iv) during the "qualified offer period," (v) which specifies the amount offered (excluding interest, unless interest is a contested issue), by stating either a precise dollar amount or a percentage of the proposed adjustments at issue, (vi) is properly designated as a qualified offer at the time the taxpayer makes it, and (vii) remains open for acceptance by the government during the period that begins on the date it is made, and ends on the date that the government rejects the offer, the date that the trial starts, or 90 days after the taxpayer makes the offer, whichever is earliest.[37]

The Preamble to the proposed regulations to Code Sec. 7430 clarifies that certain requirements are more lax when it comes to fee recoupment under the qualified offer rule:

> [A] taxpayer qualifying as a prevailing party by reason of having made a qualified offer *need not* substantially prevail on either the amount in controversy or the most significant issue or set of issues presented. Similarly, whether the positions of the [government] in the administrative and litigation proceedings were substantially justified *is not relevant* for an award under the qualified offer rule.[38]

E. Submitting the Qualified Offer to the Proper Person

The concept of the government is broad, but the regulations refine it somewhat. They state that a qualified offer ordinarily is made to the government when it is delivered to the office or personnel within the IRS, Appeals Office, Office of Chief Counsel, or Department of Justice that or who has jurisdiction over the tax matters at issue in the administrative proceeding or litigation.[39] The regulations contemplate alternative places to deliver a qualified offer, if the taxpayer is unaware of the government office or personnel with jurisdiction over the dispute.[40]

F. Period During Which Qualified Offers Can Be Made

The "qualified offer period" (i) starts the date on which the "first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review" with the IRS Appeals Office is sent, and (ii) ends 30 days before the date on which the case is first set for trial.[41] The Preamble to the proposed regulations elucidates the "qualified offer period":

> The qualified offer period ends on the date which is thirty days before the date the case is first set for trial. In cases that are pending in the United States Tax Court, cases are placed upon a calendar for trial. Each case appearing on a trial calendar is to be called at the time and place scheduled. In determining when the qualified offer period ends for cases in the Tax Court and other courts of the United States using calendars for trial, a case is considered to be set for trial on the date scheduled for the calendar call. Cases may be removed from a trial calendar at any time. Thus, a case may be removed from a calendar before the date that precedes by thirty days the date scheduled for that calendar. To promote the settlement of such cases, the qualified offer period does not end until the case remains on a calendar for trial on the date that precedes by 30 days the scheduled date of the calendar call for that trial session.[42]

G. Size of the Qualified Offer

The qualified offer rules do not demand a minimum amount, do not define the size of a reasonable offer, do not mandate that an offer be for a certain percentage of the proposed liability, *etc*. Consequently, when taxpayers are confident that they ultimately will convince a court that their liability is $0 or they are due a refund, taxpayers can make a "qualified offer" consisting of merely $1 and still recoup fees from the government.[43]

IV. TEFRA Partnerships and Qualified Offers—Limited Precedent

Cases involving whether a taxpayer is entitled to fee recoupment under Code Sec. 7430 abound, but those focused on whether TEFRA partnerships can benefit from the qualified offer rule are scarce. Indeed, just two cases, both very recent, have addressed this important issue. These cases are examined below.

A. First Case—*BASR Partnership*[44]

This case surely left a bad taste in the government's mouth. First, the IRS squandered its chance to challenge a partnership that engaged in a notorious tax shelter, a Son-of-BOSS transaction, because it issued the notice of final partnership administrative adjustment ("FPAA") too late. Second, as discussed below, the partnership made the government pay for its stubborn litigiousness, collecting administrative and legal fees after the fact under Code Sec. 7430.

1. Victory by the Partnership and Claim for Fees

The partnership engaged in a Son-of-BOSS transaction in 1999, the IRS ultimately issued an FPAA, the partnership filed a Complaint in the Court of Federal Claims ("COFC"), arguing that the IRS could not pursue the partnership because it issued the FPAA after the assessment-period had expired, and the COFC ruled in favor of the partnership.[45] Later, the partnership filed a motion for litigation costs with the COFC under Code Sec. 7430, arguing that it made a qualified offer of $1, the government rejected the offer, and the partnership ultimately won, with the COFC determining that the liability was $0.

2. Main Arguments by the DOJ

The DOJ presented three main counterarguments to the partnership's demand for fees. First, the DOJ argued that the partnership was not the "prevailing party" because the tax liability was not "in issue" in the case, citing Code Sec. 7430(c)(4)(ii)(II), which says that the qualified offer rule does not apply to "any proceeding in which the amount of tax liability is not in issue." The DOJ took the position that the decision by the COFC did not decide the liability of any partner and did not order any refund; rather, it was limited to re-determining the adjustments made to the partnership items addressed in the FPAA. Accordingly, reasoned the DOJ, the qualified offer rule cannot be applied to determine whether any taxpayer's liability, pursuant to the judgment by the COFC, was the same as or less than it would have been under a qualified offer.

Second, the DOJ maintained that the qualified offer was not made during the "qualified offer period." Code Sec. 7430(g)(2) says that this period starts "the date on which the [first] letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent." The DOJ pointed out that no "letter of proposed deficiency" was sent to the partnership, so the "qualified offer period"

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never started, which means that the partnership could not possibly have made a qualified offer during the "qualified offer period." The DOJ further argued that an FPAA does not give a partnership an opportunity for review by the Appeals Office because it is considered a "final" administrative determination, as denoted right in the name. Finally, the DOJ explained that the FPAA is not a "letter of proposed deficiency" because it does not identify the tax, penalties, or interest due.

Third, the DOJ claimed that the supposed qualified offer made by the partnership, consisting of merely $1, was a "sham," specifically made for purposes of shifting litigation costs to the government, and not done in good faith.

3. Reasoning by the COFC

The COFC ruled in favor of the partnership on the qualified offer issue, and some of its reasoning is analyzed below.

a. The Partnership Is a "Party" in the TEFRA Litigation. The COFC began with a broader issue, holding that the partnership was a "party" to the TEFRA proceeding for purposes of Code Sec. 7430. The COFC acknowledged that (i) the dispute started with the issuance of an FPAA by the IRS, followed by a "Petition for Readjustment of Partnership Items" filed by an individual partner acting in his capacity as Tax Matters Partner ("TMP") for the partnership, (ii) the Tax Court has interpreted Code Sec. 6226(c) to mean that the partners, instead of the partnership, are the parties in a TEFRA proceeding, (iii) the procedural rules of the COFC similarly state that the partner who files the Complaint, the TMP, and each person who satisfies Code Sec. 6226(c) shall be treated as a party to the case, and (iv) the Complaint did not specifically identify the partnership as a party.

Despite this, the COFC concluded that the partnership should be considered a "party" due to the special regulation directed solely to TEFRA partnerships, Reg. §301.7430-5(g), which discusses net worth and size limitations for making a qualified offer, as follows:

> (3) Others. (i) *A taxpayer that is a partnership*, corporation, association, unit of local government, or organization … meets the net worth and size limitations of this paragraph if, as of the administrative proceeding date: (A) The taxpayer's net worth does not exceed seven million dollars; and (B) The taxpayer does not have more than 500 employees.[46]
>
> (5) *Special rule for TEFRA partnership proceedings*. (i) *In cases involving partnerships* subject to the unified audit and litigation procedures of subchapter C of chapter 63 of the Internal Revenue Code (TEFRA partnership cases), *the TEFRA partnership* meets the net worth and size limitations requirements of this paragraph (g) if, on the administrative proceeding date: (A) *The partnership's* net worth does not exceed seven million dollars; and (B) *The partnership* does not have more than 500 employees.[47]

The COFC observed that the preceding regulation expressly provides that a TEFRA partnership may seek litigation costs under Code Sec. 7430, and the regulation would be "superfluous" if it applied only to individual partners.

b. The Tax Liability Is "In Issue" in TEFRA Litigation. The COFC then moved to the specific arguments raised by the DOJ about the qualified offer. It first addressed whether the tax liability was "in issue" in a TEFRA partnership case. The COFC summarized the DOJ's argument as follows: Under TEFRA, the partnership-level proceedings triggered by the FPAA do not determine the tax liability of any individual partner; rather, they determine the "partnership items" of the partnership, the proper allocation of such items among the partners, and the applicability of any penalties. The tax liabilities of particular partners are determined in subsequent proceedings at the partner level, through the issuance of Notices of Computational Adjustment. The COFC rejected the DOJ's position on the following grounds:

> Although the Government is correct that the partners' final tax liability is determined at the partner level, it is not correct that tax liability was not "in issue" in this case. The partnership-level FPAA review proceeding conclusively determines the tax treatment of all partnership items, determining each individual partner's liability … As the United States Supreme Court recognized, the court in a partnership-level TEFRA proceeding is "not required to shut its eyes" to the tax consequences of the court's decision, even if the "formal adjustment" of the partners tax liability will occur at a subsequent proceeding.

The COFC went on to explain that the partners incurred no tax liability because the partnership successfully raised a statute of limitations defense; that is, the IRS sent the FPAA too late. This was a partnership item. Then, the COFC used the government's own words against it in determining that tax liability was indeed "in issue." It underscored that, if the government had won, the FPAA would have resulted in a total increase of $6.6 million in

gain for the partners, passed through to them from the partnership, from the sale of the family business.

c. The Offer Was Made During the "Qualified Offer Period". As explained above, Code Sec. 7430(g)(2) says that the "qualified offer period" starts "the date on which the [first] letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent." The DOJ took the position that the IRS only issued an FPAA to the partnership, an FPAA does not constitute a "letter of proposed deficiency," so the "qualified offer period" never started, and the offer that the partnership made could not have possibly occurred during the "qualified offer period."

The COFC discarded this argument for several reasons, some of which are explained here. First, and most obviously, the regulations under Code Sec. 7430 specifically state that an FPAA will be treated as a Notice of Deficiency in this context: "For purposes of determining reasonable administrative costs under Section 7430 and the regulations thereunder, the following will be treated as a notice of deficiency … notice of [FPAA] described in Section 6223(a)(2)."[48] Second, both the Court of Appeals for the Fifth Circuit and the Tax Court have issued opinions in the past ruling that an FPAA is the functional equivalent of a Notice of Deficiency.[49] Third, one of the examples provided by the IRS in its regulations expressly indicates that taxpayers still get the benefit of the qualified offer rule, even though the IRS issues the taxpayer a Notice of Deficiency without first sending an Examination Report with proposed adjustments:

> During the examination of Taxpayer G's return, the IRS issues a notice of deficiency without having first issued a 30-day letter. After receiving the notice of deficiency G timely petitions the Tax Court. The next day G mails an offer to the office that issued the notice of deficiency … The office that issued the notice of deficiency transmitted the offer to the field attorney with jurisdiction over the Tax Court case. After answering the case, the field attorney refers the case to Appeals pursuant to Rev. Proc. 87-24 … After careful consideration, Appeals rejects the offer and holds a conference with G during which some adjustments are settled. The remainder of the adjustments are tried in the Tax Court, and G's liability resulting from the Tax Court's determinations, when added to G's liability resulting from the settled adjustments, is less than G's liability would have been under the offer rejected by Appeals … [E]ven though G did not receive a 30-day letter, G's offer was made after the beginning of the qualified offer period … because the issuance of the statutory notice provided G with notice of the IRS's determination of a deficiency, and the docketing of the case provided G with an opportunity for administrative review in the [Appeals Office]. Because G's offer satisfied all of the requirements of paragraph (c) of this section, the offer was a qualified offer and G is a prevailing party.[50]

For the preceding reasons and others, the COFC determined that an FPAA is tantamount to a "letter of proposed deficiency" that commences the "qualified offer period" for purposes of Code Sec. 7430.

d. An Offer of Merely $1 Suffices. The COFC swiftly rebuffed the contention by the DOJ that the qualified offer was a "sham" because it consisted of just $1. It emphasized that the relevant provision, Code Sec. 7430(c)(4)(E)(i), only requires that the ultimate tax liability be equal to or less than the amount of the taxpayer's qualified offer:

> [Code Sec. 7430] does not require any minimum amount or define the parameters of a "reasonable" offer, nor does it require that an offer be for a certain percentage of the taxpayer's purported tax liability … Indeed, the Government has offered no amount that [the partnership] could have offered that would have been "reasonable." In this case, the final judgment of the court not to sustain the FPAA on the basis that the FPAA was untimely issued resulted in $0 tax liability for [the] partners. Because $1 is more than $0, the court has determined that [the partnership's] "qualified offer" complied with [Code Sec. 7430].

B. Second Case—*Hurford Investments No. 2, Ltd.*[51]

The Tax Court held in favor of the taxpayer on its Motion for Summary Judgment in this TEFRA partnership proceeding.[52] Then, in a quest for full vindication, the taxpayer filed a motion seeking reasonable administrative and litigation costs. As the Tax Court put it, "Petitioner won [and] now petitioner wants respondent to pay the cost of his victory."[53]

1. Positions of the Parties

The partnership sought nearly $500,000 in expenses on two alternative theories. The partnership claimed that it was the "prevailing party," but even if it were not, it made

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a qualified offer to the IRS and obtained a more favorable result through Tax Court litigation.[54]

The IRS countered with several points, including that its position was "substantially justified," such that the partnership was not the "prevailing party," and the offer by the partnership did not constitute a "qualified offer."[55]

2. Reasoning by the Tax Court

The Tax Court analyzed the two main counterarguments raised by the IRS, rendering a decision on the second that stands in stark contrast to the earlier ruling by the COFC in *BASR Partnership*. This judicial divergence is explored below.

a. Was the IRS's Position Substantially Justified? The Tax Court explained that it ruled in favor of the IRS because its legal/tax position was consistent during both the administrative and litigation phases of the dispute, there was little, if any, caselaw interpreting the specific tax provisions at issue, the issues arose because of the "extraordinarily strange estate planning" by the taxpayer, the case involved a "very close question" of law, and the issue was novel, with the Tax Court observing that "there's never been any fact situation like this."[56] In light of these circumstances, the Tax Court concluded that the IRS's position was "substantially justified," meaning that the partnership was not the "prevailing party."[57]

b. Can Partnerships Make Qualified Offers? With respect to whether the partnership presented a qualified offer, the Tax Court began by reviewing certain portions of Code Sec. 7430 and the corresponding regulations. It started with Code Sec. 7430(c)(4)(i), which provides "special rules" concerning the definition of "prevailing party" when a taxpayer makes a qualified offer:

> A party to a court proceeding meeting the requirements of subparagraph (A)(ii) shall be treated as the prevailing party *if the liability of the taxpayer* pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the *liability of the taxpayer* which would have been so determined if the United States had accepted a qualified offer of the party … .[58]

The Tax Court next turned to Code Sec. 7430(g)(1)(b), which generally defines the term qualified offer, as follows:

> The term "qualified offer" means a written offer which (A) is made by the taxpayer to the United States during the qualified offer period; (B) specifies the offered amount *of the taxpayer's liability* (determined without regard to interest); (C) is designated at the time it is made as a qualified offer for purposes of this section; and (D) remains open during the period beginning on the date it is made and ending on the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made.[59]

Finally, the Tax Court cited the principal regulation about qualified offers, Reg. §301.7430-7(c)(3), which states the following:

> A qualified offer specifies the offered amount if it clearly specifies the amount for the liability of the taxpayer … The offer may be a specific dollar amount of the total liability or a percentage *of the adjustments at issue in the proceeding* at the time the offer is made. This amount must be with respect *to all of the adjustments at issue in the administrative or court proceeding* at the time the offer is made and only those adjustments. The specified amount must be an amount, the acceptance of which by the United States *will fully resolve the taxpayer's liability, and only that liability* … for the type or types of tax and the taxable year or years at issue in the proceeding … .[60]

The threshold question, according to the Tax Court, is whether a TEFRA partnership can even make a qualified offer in the first place. This is critical, because Code Sec. 7430 expressly states that the qualified offer rule does not apply to "any proceeding in which the amount of tax liability is not in issue."[61] The Tax Court indicated that the fundamental issue was "whether a TEFRA case is one in which the amount of tax liability is not in issue."[62]

The Tax Court held in favor of the IRS, thus refusing to grant fee recoupment to the partnership, on the following grounds:

> It might not, of course, be immediately obvious to a nonspecialist how [the Tax Court's] power to redetermine a deficiency is one in which tax "liability" is at issue. But that connection is a matter of chasing cross-references in the Code. "Liability" for a tax or penalty is an amount fixed by the Code sections that impose a tax or penalty. A "deficiency" is the amount by which a taxpayer's true liability under the Code exceeds the tax liability that he reported on his return. So when our Court redetermines a deficiency it must also determine a taxpayer's liability under the Code.

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> *This does not seem to be true of TEFRA cases, which means the Code's definition of a 'qualified offer' doesn't seem to fit. The chief reason is that the result of a TEFRA case is not the determination of any taxpayer's liability*.[63]
>
> The regulatory definition of a "qualified offer" that we quoted above does speak of "adjustments at issue in the proceeding." Viewed in isolation that would suggest that it is possible to make a qualified offer in a TEFRA case. *But in this TEFRA case—like most—no particular taxpayer's liability is in issue, and the name petitioner (typically a partnership) doesn't even have a tax liability under the Code, even though its partners may. We conclude from this that a partnership like [Hurford] is not even a "taxpayer."*[64]

To its credit, the Tax Court recognized that the COFC, which is the only other court to address this specific issue, in *BASR Partnership*, came to the exact opposite conclusion regarding whether a TEFRA partnership can make a qualified offer. However, the Tax Court explained that it "respectfully disagreed" with the COFC because, from its perspective, a TEFRA partnership proceeding determines only partnership items, while the liability of individual partners depends on subsequent computational adjustments and, potentially, deficiency proceedings at the individual level.[65]

C. Appellate Review of First Case—*BASR Partnership*

The DOJ filed with the Court of Appeals for the Federal Circuit an appeal of the earlier decision by the COFC. The DOJ challenged the COFC on five grounds, two of which are particularly relevant to this article. Notably, the DOJ sent a letter to the Court of Appeals several weeks before it published its opinion, drawing attention to the recent decision by the Tax Court in *Hurford Investments No. 2, Ltd.* and claiming that it directly supports the DOJ's position.[66] The Court of Appeals makes no mention whatsoever of the letter or the reasoning by the Tax Court in rendering its opinion.

1. Was the Partnership a "Party" to the TEFRA Litigation?

The DOJ repeated its previous stance that the partnership was not a "party" to the TEFRA litigation, and if it were not a "party," it surely could not have been the "prevailing party" for purposes of Code Sec. 7430.

The Court of Appeals pointed out that the trial court, the COFC, improperly relied on Reg. §301.7430-5(g) to reach its conclusion because that regulation only applies to lawsuits filed after March 1, 2016, and the Complaint was filed years earlier, in 2010. Nevertheless, the Court of Appeals characterized this error as "harmless" because it identified several other reasons to support the decision by the COFC that the partnership was, in fact, a party to the litigation.

The Court of Appeals explained that, despite the urgings of the DOJ, Code Sec. 6226(c) does not provide that the partners, instead of the partnership itself, are the parties in a TEFRA proceeding. Instead, that tax provision says that partners shall be treated as a party to the proceeding; it does *not* disqualify the partnership from also being a party. The Court of Appeals acknowledged that the Tax Court has held, at least once, that the partners are the parties, but explained that this interpretation by the Tax Court "improperly converts an inclusive statutory provision into an exclusive one." The Court of Appeals also pointed out that, on other occasions, the Tax Court has held that the partners and the TMP are the "essential" partners in the partnership proceedings, thereby leaving open the possibility that the partnership could be a non-essential party, yet a party nonetheless, to the proceeding. In all events, the Court of Appeals clarified that it is not bound by Tax Court decisions or the procedural rules for the COFC.

The Court of Appeals then noted that it and other courts have previously held that a partnership participates in the partnership-level proceeding:

> Because nothing [in Code Sec. 6226 or Code Sec. 7430] prohibits a partnership from being a party to a partnership-level TEFRA judicial proceeding, we reject the Government's argument that [the partnership], due to its partnership status, cannot legally be a party to the proceeding. To the contrary, as [the partnership] argues, the statutes at issue suggest that a partnership can receive litigation costs in a TEFRA judicial proceeding.

Next, the Court of Appeals pointed to Code Sec. 7430(c)(4)(A)(ii), which says that a party cannot be a "prevailing party" unless it meets the net worth requirements described in 28 USC §2412(d)(2)(B). Following this path, the Court of Appeals explained that 28 USC §2412(d)(2)(B), which is expressly incorporated by cross-reference, states the following:

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> For the purposes of this subsection … "party" means (i) an individual whose net worth did not exceed $2,000,000 at the time the civil action was filed, or (ii) any owner of an unincorporated business, *or any partnership*, corporation, association, unit of local government, or organization, the net worth of which did not exceed $7,000,000 at the time the civil action was filed, and which had not more than 500 employees at the time the civil action was filed … .[67]

The Court of Appeals concluded that the fact that 28 USC §2412(d)(2)(B) sets specific requirements for partnerships suggests that Congress intended for partnerships to be eligible for fee recoupment under Code Sec. 7430.

2. Was a Tax Liability "In Issue" During the TEFRA Partnership Proceeding?

The DOJ dusted off its there-is-no-liability-at-issue-in-a-TEFRA-proceeding argument for the Court of Appeals, and it was rejected more decisively the second time around.

The Court of Appeals summarized the positions of the parties as follows. The DOJ says that the amount of the tax liability must be "determined" in a proceeding in order for it to be "in issue" for purposes of Code Sec. 7430. The partnership, on the other hand, argues that the amount of tax liability only needs to be indirectly in issue in order for the qualified offer rule to apply. The Court of Appeals explained that the phrase "in issue" is not expressly defined in Code Sec. 7430, its regulations, or anywhere else in the tax laws. Therefore, the plain meaning should apply. Citing to caselaw and Black's Law Dictionary, the Court of Appeals indicated that the term "in issue" does not require a calculation or determination of a tax liability amount; it means under dispute, in question, or taking opposite sides. The Court of Appeals also warned against raising form over substance.

V. TEFRA Partnerships and Conservation Easement Donations

To appreciate the significance of the issues addressed thus far in this article, as well as the recent decisions in *BASR Partnership* and *Hurford Investments No. 2, Ltd.*, one must first understand the basic rules, terminology, and issues in cases involving charitable donations of conservation easements and the related tax deductions under Code Sec. 170(h).

A. What Is a Qualified Conservation Contribution?

Taxpayers generally may deduct the value of a charitable donation that they make during a year.[68] However, taxpayers are not entitled to deduct a donation of property, if it consists of less than their entire interest in such property.[69] One important exception is that taxpayers can deduct a donation of a partial interest in property (instead of an entire interest), provided that it constitutes a "qualified conservation contribution."[70] To meet this critical definition, taxpayers must show that they are (i) donating a qualified real property interest ("QRPI"), (ii) to a qualified organization, (iii) exclusively for conservation purposes.[71]

B. What Is a QRPI?

A QRPI can be one of several things, including a perpetual restriction on the use of a particular piece of real property.[72] These can be known by many names, among them "conservation easement," "conservation restriction," and "perpetual conservation restriction."[73] Regardless of what you call them, QRPIs must be based on legally enforceable restrictions (such as those memorialized in a Deed of Conservation Easement filed in the appropriate public record) that will prevent uses of the property, forever, that are inconsistent with the conservation purpose of the donation.[74] Stated differently, a donation is not treated as "exclusively for conservation purposes," unless the conservation purposes are "protected in perpetuity."[75]

The IRS will not disallow a tax deduction merely because the interest granted to the charitable organization might be defeated in the future as a result of some act or event, provided that, on the date that the easement is granted, it appears that the possibility that such act or event will take place is "so remote as to be negligible."[76] For instance, the fact that state law requires use restrictions, like conversation easements, to be re-recorded every 30 years to remain in force does not, alone, make easements non-perpetual.[77] Another example is where a taxpayer donates land to a city government for as long as such land is used as a park. If, as of the date of the donation, the city plans to use the land for a park, and the possibility that it could be used for another purpose is negligible, then the donation is considered perpetual, and the taxpayer is entitled to a deduction.[78]

C. For What Purposes Can Land Be Conserved?

A contribution has an acceptable "conservation purpose" if it meets one or more of the following requirements: (i) It

preserves land for outdoor recreation by, or the education of, the general public; (ii) It protects a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem; (iii) It preserves open space (including farmland and forest land) for the scenic enjoyment of the general public, and will yield a significant public benefit; (iv) It preserves open space (including farmland and forest land) pursuant to a federal, state, or local governmental conservation policy, and will yield a significant public benefit; or (v) It preserves a historically important land area or a certified historic structure.[79]

D. Can Taxpayers Still Use the Protected Property?

A taxpayer can retain certain "reserved rights," still make a qualified conservation contribution, and thus qualify for the tax deduction. However, in keeping something for themselves, taxpayers must ensure that the reserved rights do not unduly conflict with the conservation purposes.[80] The IRS openly recognizes in its Audit Technique Guide ("ATG") that reserved rights are ubiquitous, explaining the following about taxpayer holdbacks:

> All conservation easement donors reserve some rights to the property. Depending on the nature and extent of these reserved rights, the claimed conservation purpose may be eroded or impaired to such a degree that the contribution may not be allowable. A determination of whether the reserved rights defeat the conservation purpose must be determined based on all the facts and circumstances.[81]

The ATG later provides some examples for IRS personnel about reserved rights, including the following:

> Taxpayers are permitted to reserve some development rights on a portion of the property, such as construction of additional homes or structures, installation of utilities, and building of fences or roads, provided that the conservation purposes are protected. Depending on the facts and circumstances, retention of these rights may result in disallowance [of the charitable contribution tax deduction related to the easement].[82]

The regulations provide yet more specifics about reserved rights and uses that might be inconsistent with the conservation purpose of an easement:

> [A] deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests …. However, this requirement is not intended to prohibit uses of the property, such as selective timber harvesting or selective farming if, under the circumstances, those uses do not impair significant conservation interests …. A use that is destructive of conservation interests will be permitted only if such use is necessary for the protection of the conservation interests that are the subject of the contribution …. A donor may continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.[83]

E. What Is an Easement Worth?

Generally, a deduction for a charitable contribution is allowed in the year in which it occurs.[84] If the contribution consists of something other than money, then the amount of the contribution normally is the FMV of the property at the time the taxpayer makes the donation.[85] 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.[86]

Reg. §1.170A-14(h)(3) ("Easement-Valuation-Methods Regulation") provides special rules for calculating a deduction stemming from the donation of a conservation easement. The relevant portion of the Easement-Valuation-Methods Regulation, broken down to enhance readability, is set forth below[87]:

> [*General Rule*] The value of the contribution under Section 170 in the case of a charitable contribution of a perpetual conservation restriction is the [FMV] of the perpetual conservation restriction at the time of the contribution.
>
> [*Sales Comparison Method*] If there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program), the [FMV] of the donated easement is based on the sales prices of such comparable easements.
>
> [*Before and After Method*] If no substantial record of market-place sales is available to use as a meaningful or valid comparison, as a general rule (but not necessarily in all cases) the [FMV] of a perpetual conservation restriction is equal to the difference between the

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> [FMV] of the property it encumbers *before* the granting of the restriction and the [FMV] of the encumbered property *after* the granting of the restriction.
>
> [*Contiguous Property Rule*] The amount of the deduction in the case of a charitable contribution of a perpetual conservation restriction covering a portion of the contiguous property owned by a donor and the donor's family (as defined in Section 267(c)(4)) is the difference between the [FMV] of the entire contiguous parcel of property before and after the granting of the restriction.
>
> [*Enhancement Rule*] If the granting of a perpetual conservation restriction … has the effect of increasing the value of any other property owned by the donor or a related person, the amount of the deduction for the conservation contribution shall be reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous.

F. What Is the Highest and Best Use of a Property?

The IRS provides the following summary and hints about valuation to its personnel in the ATG. It explains that the best evidence of the FMV of an easement is the sale price of easements comparable to the easement in question, but, "in most instances, there are no comparable easement sales."[88] 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") *and* the corresponding FMV of the relevant property *twice*: (i) first, without regard to the easement, which generates the before value, and (ii) again, taking into account the restrictions on the property imposed by the easement, which creates the after value.[89]

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.[90] A property's HBU is the highest and most profitable use for which it is adaptable and needed, or likely to be needed, in the reasonably near future.[91] The term HBU has also been defined as the reasonably probable use of vacant land or improved property that is physically possible, legally permissible, financially feasible, and maximally productive.[92] Importantly, valuation does not depend on whether the owner has actually put the property to its HBU.[93] The HBU can be any realistic, objective potential use of the property.[94]

The Easement-Valuation-Methods Regulation provides additional guidance in situations where the appraiser uses the before-and-after method[95]:

> If before and after valuation is used, the [FMV] of the property before contribution of the conservation restriction must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use.
>
> Further, there may be instances where the grant of a conservation restriction may have no material effect on the value of the property or may in fact serve to enhance, rather than reduce, the value of the property. In such instances, no deduction would be allowable.
>
> In the case of a conservation restriction that allows for any development, however limited, on the property to be protected, the [FMV] of the property after contribution of the restriction must take into account the effect of the development.
>
> Additionally, if before and after valuation is used, an appraisal of the property after contribution of the restriction must take into account the effect of restrictions that will result in a reduction of the potential [FMV] represented by [HBU] but will, nevertheless, permit uses of the property that will increase its [FMV] above that represented by the property's current use.

The regulations contain a dozen illustrations of how values of donated property should be determined, at least from the IRS's perspective. Below is a simple example in the conservation easement context:

> C owns Greenacre, a 200-acre estate containing a house built during the colonial period. At its [HBU], for home development, the [FMV] of Greenacre is $300,000. C donates an easement (to maintain the house and Greenacre in their current state) to a qualifying organization for conservation purposes. The [FMV] of Greenacre after the donation is reduced to $125,000. Accordingly, the value of the easement

and the amount eligible for a deduction under Section 170(f) is $175,000 ($300,000 less $125,000).[96]

G. How Do Taxpayers Prove the Condition of the Property at Donation Time?

In situations involving the donation of a QRPI where the donor reserves certain rights whose exercise might impair the conservation purposes, the tax deduction will not be allowed unless the donor "makes available" to the easement-recipient, before the donation is made, "documentation sufficient to establish the condition of the property at the time of the gift."[97] This is generally called the Baseline Report.

The Baseline Report "may" (but not "must") include (i) the appropriate survey maps from the U.S. Geological Survey, showing the property line and other contiguous or nearby protected areas, (ii) a map of the area drawn to scale showing all existing man-made improvements or incursions (*e.g.*, roads, buildings, fences, or gravel pits), vegetation and identification of flora and fauna (*e.g.*, locations of rare species, animal breeding and roosting areas, and migration routes), land use history, and distinct natural features, (iii) an aerial photograph of the property at an appropriate scale taken as close as possible to the date of the donation, and (iv) on-site photographs taken at appropriate locations on the property.[98] If the easement contains restrictions regarding a particular natural resource, such as water or air quality, then the condition of the resource at or near the time of the donation must be established.[99] The Baseline Report must be accompanied by a statement signed by both the donor and recipient of the easement.[100]

H. How Do Taxpayers Claim an Easement-Related Tax Deduction?

Properly claiming the tax deduction triggered by an easement donation is, well, complicated. It involves a significant amount of actions and documents. The main ones are as follows: The taxpayer must (i) obtain a "qualified appraisal" from a "qualified appraiser," (ii) demonstrate that the easement-recipient is a "qualified organization," (iii) obtain a timely Baseline Report, generally from the easement-recipient, describing the condition of the property at the time of the donation and the reasons for which it is worthy of protection, (iv) complete a Form 8283 (*Noncash Charitable Contributions*) and have it executed by all relevant parties, including the taxpayer, appraiser, and easement-recipient, (v) assuming that the taxpayer is a partnership, file a timely Form 1065, enclosing Form 8283 and the qualified appraisal, (vi) receive from the easement-recipient a contemporaneous written acknowledgement, both for the easement itself and for any endowment/stewardship fee donated to finance the perpetual protection of the property, (vii) ensure that all mortgages on the relevant property have been subordinated or extinguished before granting the easement, and (viii) send to all partners their Schedule K-1 (*Partner's Share of Income, Deductions, Credits, etc.*) and a copy of the Form 8283.[101] Depending on the circumstances, the taxpayer might also need to file a Form 8886 (*Reportable Transaction Disclosure Statement*) and, possibly, a Form 8918 (*Material Advisor Disclosure Statement*).

VI. Content of FPAAs in Conservation Easement Disputes

In many cases, the partnership has conducted extensive and costly due diligence before donating the easement in order to determine the conservation purposes, HBU for the property, value of the easement, compliance with all laws and regulations, *etc*. In situations with an HBU of mining, this due diligence often entails obtaining from a variety of experts in their respective fields a title opinion letter, mineral remoteness evaluation, geotechnical exploration report, market analysis, mining business plan, Baseline Report, legal/tax opinion, easement appraisal, secondary easement appraisal, review easement appraisal, and more. Despite all this tangible work by the partnership, and despite the fact that the IRS practically never hires an independent appraiser, engineer, or environmentalist to analyze the documentation and issues, many FPAAs nowadays limit themselves to the following description:

> It has not been established that all the requirements of I.R.C Section 170 have been satisfied for the non-cash charitable contribution of a qualified conservation contribution. Accordingly, the charitable contribution deduction is decreased by [the entire amount claimed on the Form 1065].
>
> Alternatively, if it is determined that all the requirements of I.R.C Section 170 have been satisfied for all or any portion of the claimed non-cash charitable contribution, it has not been established that the value of the contributed property interest was greater than

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> zero …. Accordingly, the charitable contribution is decreased by [the entire amount claimed on the Form 1065].[102]

Based on the vague and incomplete descriptions above, the IRS then proposes several alternative penalties in an FPAA, ranging in severity. These often include negligence, substantial understatement of income tax, substantial valuation misstatement, gross valuation misstatement, or reportable transaction understatement penalty.[103]

This current state of affairs, particularly the ubiquitous IRS procedure of issuing FPAAs claiming easement values of $0, will trigger a seemingly endless of amount of litigation in the Tax Court and elsewhere.

This behavior by the IRS is problematic for taxpayers because (i) there is a legal presumption that what the IRS claims in the FPAA is correct, (ii) taxpayers normally cannot "go behind the FPAA" and present evidence to the Tax Court related to the audit (such as the Examination Report, Summary Report, or Notice of Proposed Adjustments), which contain detail about the IRS's positions, and (iii) taxpayers ordinarily have the burden of proof during a Tax Court trial, meaning that they have the duty to present sufficient evidence to overcome the presumed correctness of the IRS, as reflected in its FPAA.[104] Thus, the reality is that, unless the IRS later identifies the issues that it is truly challenging *via* responses to discovery requests issued by the taxpayer during Tax Court litigation, a Stipulation of Facts, a Stipulation of Settled Issues, or a Pre-Trial Memorandum, the taxpayer is obligated to present evidence at trial that it satisfied *every single requirement* on an extremely long list in order to be granted a deduction for a "qualified conservation contribution" under Code Sec. 170. The magnitude of this endeavor is illustrated by the ATG, which contains a chart spanning four pages called the "Conservation Easement Issue Identification Worksheet."[105]

VII. Conclusion

Let's summarize where we stand:

- A taxpayer generally can submit a qualified offer to the IRS indicating that it is willing to settle a case for as little as $1.
- If the IRS ignores or rejects the qualified offer, the case goes to trial, and the relevant court renders a decision indicating that the taxpayer's liability is the same as or less than the amount of the qualified offer, then the taxpayer generally can recoup reasonable administrative and/or litigation costs from the IRS starting from the time that the taxpayer made the qualified offer.
- A taxpayer can file a qualified offer as soon as the IRS issues the "first letter of proposed deficiency which allows a taxpayer an opportunity for administrative review" by the IRS Appeals Office, which, in the case of a TEFRA partnership dispute, would mean a Summary Report, Notice of Proposed Adjustment, or FPAA.
- The costs associated with defending an IRS challenge to a conservation easement deduction can be hefty, given the need to (i) counter all the "technical" arguments raised by the IRS under Code Sec. 170 and its dense regulations, (ii) fully develop a significant amount of detailed facts involving complex topics, and (iii) utilize a posse of expert witnesses to address biological, ecological, financial, geotechnical, historical, valuation, and other issues.
- Only two cases have analyzed the issue of whether a TEFRA partnership is entitled to make a qualified offer, *BASR Partnership* and *Hurford Investments No. 2. Ltd.*, with the Court of Federal Claims and the Court of Appeals for the Federal Circuit ruling that partnerships can, indeed, make qualified offers, and the Tax Court concluding the opposite.[106]
- Importantly, the Tax Court issued its decision in *BASR Partnership* via an "Order," and Tax Court Rule 50(f) explicitly states that "Orders shall *not* be treated as precedent, except as may be relevant for purposes of establishing the law of the case, res judicata, collateral estoppel, or other similar doctrine."
- The U.S. government has recently started aggressively attacking certain partnerships that make easement donations to charitable organizations, by (i) issuing Notice 2017-10 and identifying them as "listed transactions," thereby mandating the filing of Form 8886 (*Reportable Transaction Disclosure Statement*) and Form 8918 (*Material Advisor*

Disclosure Statement) by various parties, (ii) adding certain easement transactions to the list of "compliance campaigns" launched by the IRS, (iii) filing a Complaint in District Court in Georgia seeking a permanent injunction of easement-related activities by certain appraisers and organizers, (iv) including conservation easement transactions on the IRS's list of the "dirty dozen," (v) launching a congressional inquiry regarding potential abuses in the easement area, and (vi) as indicated above, engaging in a widespread practice of issuing FPAAs to partnerships alleging that their easement-related tax deduction should be $0 and they should be severely penalized, despite the extensive due diligence conducted by the partnerships, and the near absence of such diligence by the IRS.

This current state of affairs, particularly the ubiquitous IRS procedure of issuing FPAAs claiming easement values of $0, will trigger a seemingly endless of amount of litigation in the Tax Court and elsewhere. Perhaps more importantly, at least from the government's perspective, is that this situation is also likely to elicit lots of qualified offers from partnerships, which, at the time that the qualified offer period starts, have a significant informational advantage over the IRS about the true value of the easement. If the IRS persists in issuing FPAAs and other notices to partnerships alleging tax deductions of $0, and partnerships submit realistic qualified offers, the IRS might see its full-deduction-disallowance-plus-imposition-of-high-penalties strategy flop, as the IRS is forced to pay large administrative and/or litigation costs.

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ENDNOTES

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[1] Code Sec. 7430(a).

[2] Code Sec. 7430(c)(2).

[3] Code Sec. 7430(c)(1).

[4] Code Sec. 7430(c)(4)(A).

[5] Reg. §301.7430-5(g)(5).

[6] Reg. §301.7430-5(g)(6); T.D. 9756 (Mar. 1, 2016), Preamble.

[7] Code Sec. 7430(b)(1).

[8] Code Sec. 7430(b)(1).

[9] CCA 200919037 (May 8, 2009).

[10] Code Sec. 7430(b)(3).

[11] Code Sec. 7430(c)(4)(B)(i).

[12] The Taxpayer Bill of Rights 2, P.L. 104-168.

[13] H.R. Rept. 104-506, 104th Cong., 2d Sess. 1996, at 37.

[14] P.L. 104-168, §701; H.R. Rept. 104-506, 104th Cong., 2d Sess. 1996, at 36–37.

[15] The Taxpayer Bill of Rights 3, P.L. 105-206.

[16] P.L. 105-206, §3101, codified as Code Sec. 7430(c)(4)(B)(iii).

[17] H.R. Rept. 105-364, 105th Cong., 1st Sess. 1997, at 58; Sen. Rept. 105-174, 105th Cong., 2d Sess., 1998, at 48.

[18] *Id*.

[19] Code Sec. 7430(c)(4)(B)(i).

[20] Code Sec. 7430(c)(4)(B)(ii).

[21] Code Sec. 7430(c)(4)(B)(iv)(I); Reg. §301.7430-5(c)(3).

[22] Code Sec. 7430(c)(4)(B)(iv)(II); Reg. §301.7430-5(c)(3).

[23] Code Sec. 7430(c)(4)(B)(iii).

[24] Reg. §301.7430-5(c)(1).

[25] Reg. §301.7430-5(c)(1); Reg. §301.7430-5(h) Ex. 1.

[26] *National Federation of Republican Assemblies*, DC-AL, 2003-1 USTC ¶50,249, 263 FSupp2d 1372, 1378.

[27] *R.C. Kennedy, Sr.*, 89 TC 98, Dec. 44,046 (1987) (holding that the IRS's position was unreasonable where it acted contrary to its own regulations, contrary to case law, and without factual support).

[28] *N.R. Wilkes, Jr.*, CA-11, 2002-1 USTC ¶60,438, 289 F3d 684, 688.

[29] *See, e.g., M.J. Downing*, 89 TCM 1009, Dec. 55,983(M), TC Memo. 2005-73.

[30] Code Sec. 7430(c)(4)(E)(i); Reg. §301.7430-7(a); Reg. §301.7430-7(b)(1); Reg. §301.7430-7(b)(2) provides that interest is not counted, unless the taxpayer's liability for, or entitlement to, interest is a contested issue in the administrative proceeding or litigation, and is one of the issues addressed in the last qualified offer.

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[31] Code Sec. 7430(c)(4)(E)(ii); Reg. §301.7430-7(a).
[32] T.D. 8922 (Jan. 4, 2001), Preamble; *see also* Code Sec. 7430(c)(4)(E)(ii); Reg. §301.7430-7(a).
[33] Reg. §301.7430-7(e) Example 8.
[34] T.D. 9106 (Dec. 24, 2003), Preamble (emphasis added). Court rulings relating to discovery, admissibility of evidence, and burden of proof are not treated as rulings that substantially resolve adjustments covered by a qualified offer. *Id*.
[35] T.D. 9106 (Dec. 24, 2003), Preamble.
[36] Code Sec. 7430(c)(4)(E)(iii).
[37] Code Sec. 7430(g)(1); Reg. §301.7340-7(c)(1); Reg. §301.7430-7(c).
[38] T.D. 8922 (Jan. 4, 2001), Preamble (emphasis added); *see also* Reg. §301.7430-7(b)(1).
[39] Reg. §301.7430-7(c)(2)(i).
[40] *Id*.
[41] Code Sec. 7430(g)(2); Reg. §301.7430-7(c)(7).
[42] T.D. 8922 (Jan. 4, 2001), Preamble.
[43] *BASR Partnership*, FedCl, 2017-1 USTC ¶50,144, 130 FedCl 286, 119 AFTR 2d 2017-614.
[44] *Id.*
[45] *BASR Partnership*, FedCl, 2013-2 USTC ¶50,527, 113 FedCl 181, 112 AFTR 2d 2013-6313.
[46] Reg. §301.7430-5(g)(3)(i) (emphasis added).
[47] Reg. §301.7430-5(g)(i) (emphasis added).
[48] Reg. §301.7430-3(c)(3)(i).
[49] *See Sealy Power, Ltd.*, CA-5, 95-1 USTC ¶50,103, 46 F3d 382, 385 and *Clovis I*, 88 TC 980, 981, Dec. 43,856 (1987).
[50] Reg. §301.7430-7(e) Example 14.
[51] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order (Dec. 21, 2018).
[52] *T.G. Hurford Est.*, 96 TCM 422, Dec. 57,610(M), TC Memo. 2008-278.
[53] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order (Dec. 21, 2018), at 4–5.
[54] *Id*., at 5.
[55] *Id.*
[56] *Id*., at 6.
[57] *Id.*
[58] Code Sec. 7430(c)(4)(i) (emphasis added by Tax Court).
[59] Code Sec. 7430(g)(1)(b) (emphasis added by Tax Court).
[60] Reg. §301.7430-7(c)(3) (emphasis added by Tax Court).
[61] Code Sec. 7430(c)(4)(e)(ii)(II).
[62] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, December 21, 2018, at 8.
[63] *Id*., at 9.
[64] *Id*., at 10.
[65] *Id*., at 12. The Tax Court indicated that, even if partnerships could make qualified offers in a TEFRA proceeding, the specific offer made by the partnership in this case would be not considered a qualified offer because it was not limited to the adjustments in the FPAA, as required by the regulations. Instead, it attempted to settle the effect of the TEFRA proceeding on the liability of the individual partners. *Id*.
[66] Tax Notes Document No. 2019-4901 (Jan. 30, 2019).
[67] 28 USC §2412(d)(2)(B) (emphasis added by Court of Appeals).
[68] Code Sec. 170(a)(1); Reg. §1.170A-1(a).
[69] Code Sec. 170(f)(3)(A); Reg. §1.170A-7(a)(1).
[70] Code Sec. 170(f)(3)(B)(iii); Reg. §1.170A-7(a)(5).
[71] Code Sec. 170(h)(1).
[72] Code Sec. 170(h)(2); Reg. §1.170A-14(a); Reg. §1.170A-14(b)(2).
[73] Reg. §1.170A-14(b)(2).
[74] Reg. §1.170A-14(g)(1); *J.D. Turner*, 126 TC 299, 311, Dec. 56,522 (2006).
[75] Code Sec. 170(h)(5)(A); Reg. §1.170A-14(e)(1).
[76] Reg. §170A-14(g)(3).
[77] *Id*.
[78] Reg. §170A-1(e).
[79] Code Sec. 170(h)(4)(A); Reg. §170A-14(d)(1); S. Rept. 96–1007, at 10 (1980).
[80] Reg. §1.170A-14(b)(2).
[81] Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. Nov. 4, 2016), at 23.
[82] *Id*., at 63.
[83] Reg. §1.170A-14(e)(2) and (3).
[84] Code Sec. 170(a)(1).
[85] *Id*.; Reg. §1.170A-1(c)(1).
[86] Reg. §1.170A-1(c)(2).
[87] Reg. §1.170A-14(h)(3)(i).
[88] Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. Nov. 4, 2016), at 41.
[89] *Id*.
[90] *Stanley Works & Subs.*, 87 TC 389, 400, Dec. 43,274 (1986); Reg. §1.170A-14(h)(3)(i).
[91] *Olson*, SCt, 292 US 246, 255 (1934).
[92] *Esgar Corp.*, CA-10, 2014-1 USTC ¶50,207, 744 F3d 648, 659 n.10.
[93] *Id*., at 657.
[94] *J.W. Symington*, 87 TC 892, 896, Dec. 43,467 (1986).
[95] Reg. §1.170A-14(h)(3)(ii).
[96] Reg. §1.170A-14(h)(4). Example 7.
[97] Reg. §1.170A-14(g)(5)(i).
[98] *Id*.
[99] *Id*.
[100] *Id*.; Internal Revenue Service Conservation Easements Audit Techniques Guide (Rev. Nov. 4, 2016), at 24.
[101] *See* Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. Nov. 4, 2016), at 24–30; IRS Publication 1771, *Charitable Contributions—Substantiation and Disclosure Requirements*; IRS Publication 526, *Charitable Contributions*; Code Sec. 170(f)(8); Code Sec. 170(f)(11); Reg. §1.170A-13; Notice 2006-96; T.D. 9836.
[102] *See, e.g., Champions Retreat Golf Founders, LLC*, 116 TCM 262, Dec. 61,260(M), TC Memo. 2018-146.
[103] Code Sec. 6662; Code Sec. 6662A. This is consistent with the IRS's internal guidance to Revenue Agents, which directs them to assert a "tiering of proposed penalties with multiple alternative positions." *See* Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. Nov. 4, 2016), at 77.
[104] Tax Court Rule 142(a); *Greenberg's Express, Inc.*, 62 TC 324, Dec. 32,640 (1974).
[105] Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. Nov. 4, 2016), at 78–81.
[106] While beyond the scope of this article, note that the new partnership-level audit rules, which are effective beginning in 2018, provide for a subject partnership to be liable for an assessment resulting from a partnership-level audit (subject to the ability of the partnership to push out the tax to its partners). One might speculate that this imposition of tax might change the approach of the Tax Court as to whether a partnership can make a qualified offer with respect to post-2017 tax years, or at least change its approach when there is no push-out election.

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