New Cases Clarify Standards for Reimbursements to Taxpayers under Section 7430

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Among the biggest hurdles for taxpayers is demonstrating that positions taken by the IRS during a dispute were not "substantially justified."

Defeating the IRS triggers extreme vindication for most taxpayers, but winning against the IRS and then obligating it to pay legal, accounting, expert and other fees is sublime. The mechanism for achieving this elusive double victory is found in Section 7430. Getting the IRS to reimburse taxpayers for their trouble is not easy, of course. Among the biggest hurdles for taxpayers is demonstrating that positions taken by the IRS during a dispute were not "substantially justified." A thorny sub-issue is whether courts, in analyzing this question, must focus on the IRS's *overall theory* for a taxpayer's liability or on *each of the underlying arguments* to support such theory. This matter is common in tax disputes because the IRS ordinarily raises numerous alternative arguments to fortify its overarching theory that a particular taxpayer owes taxes, penalties, and interest. The IRS only needs to win one argument, but it presents many to hedge its bets.

This article describes key aspects of fee recoupment under Section 7430, analyzes three recent cases addressing the holistic versus issue-by-issue focus, highlights procedural rules on which the IRS depends in issuing final notices to taxpayers devoid of meaningful information, and explains how Section 7430 actions might increase in the near future.

Recouping Costs from the Government

In certain circumstances, taxpayers who defeat the IRS are not only liberated

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from paying taxes, penalties, and interest, but they also get absolution in the form of cost reimbursement. This possibility derives from Section 7430, several aspects of which are described below.

Congressional Purpose

According to the legislative history, the objective of Section 7430 is to "deter abusive actions or overreaching by the Internal Revenue Service and . . . enable individual taxpayers to vindicate their rights regardless of their economic circumstances."[1]

Overview. Generally, Section 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.[2] 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.[3] Litigation costs for which the taxpayer may seek reimbursement follow similar guidelines.[4] This article explains various aspects of recovery pursuant to Section 7430 below.

Standards. The term "prevailing party" generally means a party in any tax-related administrative proceeding or litigation that has substantially prevailed with respect to either the amount in controversy or the most significant issues presented, and has a net worth that does not exceed the statutory thresholds.[5]

Exhausting Administrative Remedies. Even if a taxpayer 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.[6] This mandate does not obligate the taxpayer to grant the IRS extensions of the assessment-period.[7] However, in a Chief Counsel Advice noteworthy for its muddled reasoning, the IRS indicated that taxpayers must always exhaust administrative remedies, which includes participating in a conference with the Appeals Office, regardless of whether they are seeking cost recoupment under a "prevailing party" or "qualified offer" theory.[8]

No Unreasonable Delays. To preserve eligibility for fee recoupment, the taxpayer cannot "unreasonably protract" the proceedings with the government.[9]

Substantial Justification. As explained above, the term "prevailing party" generally means a party in any tax-related administrative proceeding or litigation that has substantially prevailed with respect to either the amount in controversy or the most significant issue or set of issues presented, and has a net worth that does not exceed certain limits.[10] Even if the taxpayer meets these two criteria, the taxpayer nonetheless will *not* be deemed the "prevailing party" if the government establishes that its position was "substantially justified."[11] Stated another way, if the government manages to prove that the position it took during the dispute was substantially justified, then the taxpayer cannot recover 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 taxpayers.[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

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1 H.R. Rep. No. 97-404, 97th Cong., 1st Sess. at 11 (1981).
2 Section 7430(a).
3 Section 7430(c)(2).
4 Section 7430(c)(1).
5 Section 7430(c)(4)(A). In cases involving partnerships that are subject to the special partnership-level proceedings, 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. *See* Treas. Reg. § 301.7430-5(g)(5).
6 Section 7430(b)(1).
7 Section 7430(b)(1).
8 Chief Counsel Advice 200919037 (May 8, 2009).
9 Section 7430(b)(3).
10 Section 7430(c)(4)(A).
11 Section 7430(c)(4)(B)(i).
12 P.L. 104-168.
13 H.R. Rept. 104-506, 104th Cong., 2d Sess. 1996, pg. 37.
14 P.L. 104-168, § 701; H.R. Rept. 104-506, 104th Cong., 2d Sess. 1996, pgs. 36-37.
15 P.L. 105-206.
16 P.L. 105-206, § 3101, codified as Section 7430(c)(4)(B)(iii).
17 H.R. Rept. 105-364, 105th Cong., 1st Sess. 1997, pg. 58; Sen. Rept. 105-174, 105th Cong., 2d Sess., 1998, pg.48.
18 H.R. Rept. 105-364, 105th Cong., 1st Sess. 1997, pg. 58; Sen. Rept. 105-174, 105th Cong., 2d Sess., 1998, pg.48.
19 Section 7430(c)(4)(B)(i).
20 Section 7430(c)(4)(B)(ii).
21 Section 7430(c)(4)(B)(iv)(I); Treas. Reg. § 301.7430-5(c)(3).

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]

The regulations provide additional clarity regarding what constitutes a substantial justification. Specifically, they explain that the government's position is substantially justified only if it has a reasonable basis in both fact and law.[23] A significant factor in making this determination is whether the taxpayer presented all the relevant information under his control to the appropriate IRS personnel.[24]

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.[25] Other courts have utilized a different approach, scrutinizing whether the position taken by the IRS was reasonable.[26] 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."[27] Still other courts rely on a different test, framing the question as whether the government knew, or should have known, that its position was invalid at the time it took it.[28]

Cases Refining the Concept of Substantial Justification

The preceding segment of this article demonstrates that whether the IRS lacked a substantial justification for pursuing a taxpayer, either from the outset or later in the process, is a pivotal issue. A corollary to that is whether, when conducting its analysis in a tax dispute involving multiple claims by the IRS, a court should evaluate the IRS's position as a whole or on a line-by-line basis. The following three cases focus on this important sub-issue.

Fourth Circuit Court of Appeals – *Roanoke River Basin Associates*

Roanoke River Basin Associates involved neither taxes nor Section 7430.[29] Instead, it was a water dispute centered on the Equal Access to Justice Act ("EAJA").[30] The EAJA, like Section 7430, provides that parties that prevail in litigation against the government ordinarily can recoup their legal fees, unless the position of the government was "substantially justified."

The State of North Carolina and others interested in protecting the water resources of the Roanoke River Basin sued a long list of parties, including the Army Corps of Engineers ("Corps"), over its issuance of a permit to the City of Virginia Beach. Such permit allowed diversion of about 60 million gallons of water per day from a lake located in the Roanoke River Basin to Virginia Beach. A group called the Roanoke River Basin Associates ("RRBA") intervened in the litigation, filing a Complaint with the District Court comprised of nine counts. The District Court rejected nearly all counts raised by the RRBA, but it acknowledged that the Corps had neglected to consider some relevant factors in two instances. Therefore, the District Court remanded the two issues to the Corps for further development and retained jurisdiction over the case. The Corps then gathered additional evidence, conducted more public hearings, and issued a supplemental report arriving at the same conclusion; that is, the permit was appropriate. The District Court agreed.

The RRBA persisted, though, filing a Petition with the District Court under the EAJA, demanding legal fees solely with respect to the two issues sent back to the Corps. The District Court determined that the RRBA was the prevailing party on those issues, but declined to award legal fees because the position of the Corps was substantially justified. In making this decision, the District Court looked to the overall position of the Corps during the entire proceeding, not just to the narrow, specific issues remanded to the Corps.

Dissatisfied with the decision by the District Court about fee recoupment, the RRBA elevated the matter to the Fourth Circuit Court of Appeals. There, it advanced the theory that the District Court erred by considering the litigating positions as a whole instead of focusing solely on the issues where the RRBA prevailed. The Fourth Circuit summarized the issue as follows: "[W]hether we focus only on the issue on which the fee-petitioning-party prevailed or on the entire litigation when determining whether the government's position was substantially justified."

The Fourth Circuit started with some background about the EAJA, explaining that (i) Congress was concerned about civil actions in which the government challenges private parties whose financial resources are significantly smaller, (ii) without the EAJA and other fee-shifting statutes, private parties might be "coerced" into agreeing to outcomes that constitute an unreasonable use of governmental power and/or reflect an inaccurate application of law, (iii) a more balanced adversarial process serves the public interest, and (iv) Congress intended to stop governmental misconduct, before or during litigation, in the form of advancing unreasonable positions. Based on its review of legislative history and an earlier Supreme Court case, the Fourth Circuit reasoned as follows:

> [W]e conclude that when determining whether the government's position in a case is substantially justified, we look beyond the issue on which the petitioner prevailed to determine, from the totality of the circumstances, whether the government acted reasonably in causing the litigation or in taking a stance during the litigation. In doing so, it is appropriate to consider the reasonable overall objectives of the government and the extent to which the alleged governmental misconduct departed from them.
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> Thus a more egregious example of misconduct might, even if confined

to a narrow but important issue, taint the government's "position" in the entire case as unreasonable, whereas a totally insupportable and clearly unreasonable position by the government on an inconsequential aspect of the litigation might not. Similarly, a broad government position that, considered in a vacuum, would not be clearly egregious might still, in the overall context of the case, constitute an unreasonable position because of its impact. Although an unreasonable stance taken on a single issue may thus undermine the substantial justification of the government's position, that question can be answered only by looking to the stance's effect on the entire civil action. We therefore conclude that, while a party may become a "prevailing party" on a single substantive issue from which benefit is derived, satisfying one prong of the EAJA, it does not automatically follow that the government's position in the case as a whole is not substantially justified.

Applying this thought process, the Fourth Circuit ultimately decided that the District Court did nothing wrong when it considered the position of the Corps in the entire case and that temporary deficiencies with respect to two issues did not render the position unreasonable.

Tenth Circuit Court of Appeals – *United States v. Johnson*

The government filed a Complaint in *United States v. Johnson* to collect federal estate taxes from the children of the deceased pursuant to multiple legal theories.[31] The factual and procedural aspects of this case are dense. Suffice it to understand that the District Court initially ruled for the children on the substantive issues and then awarded them legal fees under Section 7430. The fighting continued, and the Tenth Circuit Court of Appeals ultimately held in favor of both the government and the children in certain respects. With regard to the issue of fee recoupment by the children, the Tenth Circuit indicated that it was not necessary to determine to what extent the children were the "prevailing party" because the government's position was "substantially justified."

The first chore for the Tenth Circuit was determining whether the term "position," as used in Section 7430, means the government's "overall contention" as to the liability of a taxpayer, or the "individual arguments" that the government makes as to each underlying theory for such liability. In resolving this keynote issue, the Tenth Circuit analyzed *Roanoke River Basis Association*, along with two other cases involving claims for fee recoupment under the EAJA. The Tenth Circuit concluded that the District Court had previously erred "by improperly focusing on the correctness of the government's argument on each claim for relief rather than properly focusing on whether there was a reasonable basis both in law and fact for the government's overall position in the litigation."

The Tenth Circuit went on to explain that, in a multi-issue lawsuit, the holistic approach requires considering the reasonableness of the government's position in initiating and continuing litigation, not the government's success or failure on a particular theory. Moreover, suggested the Tenth Circuit, in a tax case where the government raises numerous theories to recover only a single tax liability, it would be "incongruous" to conclude that its position was unjustified where the government ultimately obtains a judgment "for the full amount sought." The Tenth Circuit explained that such reasoning is valid, even if one or more of the government's alternative claims are dismissed, because the government cannot recover more than the total amount of taxes due, regardless of how many legal theories are successful.

Applying that rationale to the case at hand, the Tenth Circuit explained that the government took one overarching position in the litigation, which was that the children were liable for the estate taxes under various, alternative legal theories. The Tenth Circuit ruled that the children were liable for all the taxes under one such theory. Therefore, concluded the Tenth Circuit, the government's position was substantially justified for purposes of Section 7430 because "it obtained judgment for the full amount sought."

Tax Court – *Morreale v. Commissioner*

In the most recent case, issued in July 2021, *Morreale v. Commissioner*, the taxpayer owned and operated hotels and restaurants.[32] He failed to file Forms 1040 (U.S. Individual Income Tax Returns) for 2011 and 2012, and the IRS audited. As part of the process, the taxpayer submitted Forms 1040 to the Revenue Agent, who compared them to the data about the businesses that he already had in his possession. The Revenue Agent raised two key issues, namely, whether the taxpayer had established his tax basis in one of the partnerships

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

[23] Treas. Reg. § 301.7430-5(c)(1).

[24] Treas. Reg. § 301.7430-5(c)(1); Treas. Reg. § 301.7430-5(h), Ex. 1.

[25] *National Federation of Republican Assemblies v. United States*, 263 F. Supp. 2d 1372, 1378 (S.D. Ala. 2003).

[26] *Kennedy v. Commissioner*, 89 T.C. 98 (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).

[27] *Wilkes v. United States*, 289 F.3d 684, 688 (11th Cir. 2002).

[28] *See, e.g., Downing v. Commissioner*, T.C. Memo 2005-73.

[29] *Roanoke River Basin Associates v. North Carolina et al*, 991 F.2d 132 (4th Cir. 1993).

[30] 28 U.S.C. § 2412

[31] *United States v. Johnson*, 920 F.3d 639 (10th Cir. 2019). See earlier, related proceedings at *United States v. Johnson*, 224 F. Supp. 3d 1220 (D.C. Utah 2016) and *United States v. Johnson*, 121 AFTR 2d 2018-341 (D.C. Utah 2018).

[32] *Morreale v. Commissioner*, T.C. Memo 2021-90.

[33] Section 7522(a) (emphasis added).

[34] U.S. House of Representatives, Technical and Miscellaneous Revenue Act of 1988, 100th Congress, Second Session, Conference Report, Report 100-1104, Volume II (October 21, 1988), pg. 219.

[35] *Rochelle v. Commissioner*, 116 T.C. 356 (2001).

[36] *Schmaus v. Commissioner*, TC Memo 1967-197.

[37] *Stevenson v. Commissioner*, TC Memo 1982-16.

[38] *Flynn v. Commissioner*, 40 T.C. 770 (1963).

[39] *QinetiQ U.S. Holdings, Inc. v. Commissioner*, TC Memo 2015-123, *aff'd* 119 AFTR 2d 2017-330 (4th Cir. 2017) (the Notice of Deficiency stated that the deduction for wages that the taxpayer claimed under Section 83 was disallowed in full "as you have not established that you are entitled to such a deduction.")

[40] *Crandall v. Commissioner*, TC Memo 2021-39, pgs. 14-15 (emphasis added).

[41] Tax Court Rule 142(a)(1).

[42] U.S. House of Representatives, Internal Revenue Service Restructuring and Reform Act of 1997. 105th Congress, 1st Session. Report 105-364 (Oct. 31, 1997), pg. 55; U.S. Senate, Internal Revenue Service Restructuring and Reform Act of 1998. 105th Congress, 2nd Session. Report 105-174 (April 22, 1998), pg. 43

and whether the taxpayer was using the proper method of accounting.

To substantiate tax basis, the taxpayer supplied the Revenue Agent with a spreadsheet, prepared by his accountant, with a "detailed summary" of his basis in the partnership since inception. The Revenue Agent apparently ignored the spreadsheet. With respect to the issue of accounting methods, the taxpayer provided the Revenue Agent financial statements demonstrating that he had consistently employed the accrual method. The taxpayer also supplied the applicable regulation, which mandates that businesses carrying inventory, like his, must use the accrual method. The Revenue Agent also seemed to disregard the statements and regulation, relying instead on one contact with a former accountant for the taxpayer who supposedly recalled preparing certain tax returns using the cash basis.

The Revenue Agent then issued an Examination Report, proposing significant tax liabilities and penalties for 2011 and 2012. The Revenue Agent later issued a "revised" Examination Report somewhat reducing the proposed adjustments. The IRS eventually sent a Notice of Deficiency, which reflected the same issues as the earlier Examination Report. The taxpayer filed a Petition with the Tax Court disputing the Notice of Deficiency, and the IRS attorney responded with an Answer, which essentially repeated the same claims as the previous Examination Report and Notice of Deficiency. The IRS, in short, never changed its tune.

The case was then routed back to the Appeals Office for possible pre-trial settlement. The Appeals Officer ruled in favor of the taxpayer on the two main issues. Specifically, he recommended that the IRS fully concede the tax basis issue because the taxpayer provided adequate substantiation during the audit. He further determined that the taxpayer was correctly using the accrual method for his businesses, and that the Revenue Agent lacked sufficient evidence to support his cash method claim.

In accordance with the conclusions of the Appeals Officer, the IRS attorney conceded the two issues via a Stipulation of Settled Issues filed with the Tax Court. He also waived all penalties. In other words, the IRS attorney acknowledged that the taxpayer had prevailed on the two pivotal matters in dispute. The taxpayer then filed a Motion with the Tax Court seeking recoupment of legal fees, which the IRS, predictably, opposed. In resolving this matter, the Tax Court looked heavily to *Johnson*, which, in turn, had relied in large part on *Roanoke River Basin Associates*.

Even though it eventually conceded the partnership basis and accounting method issues in favor of the taxpayer, the IRS argued that it had prepared the Examination Report and later the Notice of Deficiency based on the best information available at the time. The taxpayer countered that the Revenue Agent possessed the relevant data (*i.e.*, the spreadsheet showing the basis calculation, financial statements, and the applicable regulation) before he issued the Examination Report, yet chose to disregard them. The IRS then compounded the problem by later issuing the Notice of Deficiency, again ignoring the evidence. For these reasons, concluded the taxpayer, the IRS lacked a substantial justification for its positions since early in the process.

The Tax Court explained that, under the recent standard established in *Johnson*, it must evaluate the IRS's position holistically, considering all the relevant facts and circumstances, when determining whether the IRS was substantially justified. Importantly, the Tax Court indicated that it must go beyond the Notice of Deficiency and Answer to decipher the IRS's position. It first explained that the contents of such documents "help to explain the position" of the IRS, but that they do not constitute the end of the analysis. The Tax Court then emphasized that it must examine the "building blocks" of the IRS's position to determine whether it was, on the whole, substantially justified. The Tax Court went on to explain that it was necessary to take into consideration the IRS's contentions about tax basis and accounting methods "asserted [by the Revenue Agent] during the examination because they formed the basis of the Notice of Deficiency and were later adopted in [the IRS's] Answer."

The Tax Court reviewed the audit records in concluding that the Revenue Agent's position about partnership basis lacked a reasonable basis because he failed to consider the basis-computation spreadsheet provided by the taxpayer before issuing the Examination Report. With regard to the accounting method issue, the Tax Court confirmed that the relevant regulation mandates use of the accrual method for businesses carrying inventory, and the taxpayer's businesses had inventory. Consequently, the IRS lacked a reasonable factual or legal basis for its position, as stated in the Notice of Deficiency and Answer. Moreover, because the IRS's position was contrary to its own published guidance (*i.e.*, the regulations), the Tax Court was "compelled to presume that the overall position of the United States was not substantially justified."

In a last-ditch effort to salvage matters, the IRS argued that it was justified nonetheless regarding the accounting method issue because it raised an alternative reason in the Notice of Deficiency, *i.e.*, the alleged failure by the taxpayer to provide adequate substantiation. The Tax Court rejected the IRS's contention for several reasons. The Tax Court first noted that the accounting method was a "threshold issue" during the audit, and whether the taxpayer adequately substantiated expenses was a secondary matter, dependent on the applicable accounting method. The Tax Court then emphasized that the more important matter was that, under the standard established in *Johnson*, (i) the Tax Court "does not look granularly at the basis of each dispute to attempt to identify a saving basis for the government," (ii) Section 7430 must be a "viable path for fee awards in proper circumstances," and (iii) in conducting its analysis, the Tax Court must look to the "overall reasonableness" of the government's position in both starting and continuing the relevant litigation. Finally, the Tax Court held that the IRS's position was contrary to the pertinent regulation, devoid of a factual basis, and "tainted the government's position in the entire case."

Pertinent Tax Procedures

To understand the importance of the three cases examined above, particularly *Morreale*, readers first need some additional foundation regarding critical tax procedures.

Content of IRS Notices

Section 7522 generally requires that certain documents issued by the IRS, including Notices of Deficiency, "describe the basis for" and "identify the amounts of" any proposed taxes, penalties, interest, and other items. However, to the frustration of taxpayers, the provision goes on to state that "[a]n inadequate description . . . shall *not* invalidate the notice."[33]

> The legislative history describes the objective of Section 7522:
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> Although [Section 7522] is limited to specific notices [including Notices of Deficiency], the conferees believe that all correspondence should be sufficiently clear to enable a taxpayer to understand an IRS question about a tax return as well as any adjustments or penalties applied to a tax return.[34]

Despite the statutory language and congressional intent, the courts have frequently upheld IRS notices with serious shortcomings. For example, the courts have ruled that Notices of Deficiency were valid even though they (i) failed to specify the last day for filing a Petition with the Tax Court,[35] (ii) stated an incorrect reason for the tax adjustment,[36] (iii) omitted the tax provision, regulation, case or other support for the proposed liability,[37] (iv) contained legal or tax theories that were not raised in earlier Examination Reports,[38] (iv) merely concluded, without supplying any detail whatsoever, that all deductions were disallowed because the taxpayer did not establish that he was entitled to them,[39] or (v) featured conflicting grounds for and a "confusing description" of the proposed adjustments.[40]

The Tax Court Presumes that the IRS Is Correct

There is a general presumption in federal tax disputes that determinations made by the IRS during an audit are correct.[41] In other words, when the IRS alleges in a Notice of Deficiency or similar document that a taxpayer owes additional taxes, penalties, and interest, the Tax Court starts with the notion that what the IRS claims is true. Legislative history explains that this rule, which surprises and offends many taxpayers raised in the tradition of innocent until proven guilty, derives from case law and enjoys support from Congress:

> The general rebuttable presumption that the [IRS's] determination of tax liability is correct is a fundamental element of the structure of the Internal Revenue Code. Although this presumption is judicially based, rather than legislatively based, there is considerable evidence that the presumption has been repeatedly considered and approved by the Congress. This is the case because the Internal Revenue Code contains a number of civil provisions that explicitly place the burden of proof on the [IRS] in specifically designated circumstances. The Congress would have enacted these provisions only if it recognized and approved of the general rule of presumptive correctness of the [IRS's] determination.[42]

Notice of Deficiency as Starting Point

Ordinarily, the starting point of a tax dispute, at least from the perspective of the Tax Court, is when the IRS issues the final notice triggering the right of the taxpayer to file a Petition with the Tax Court, such as a Notice of Deficiency. What occurred before that time, such as during the audit with the Revenue Agent or administrative review with an Appeals Officer, normally is irrelevant to the Tax Court. The case most commonly cited for this rule, *Greenberg's Express,* states the following about the Tax Court's tendency not to look backward:

> As a general rule, this [Tax] Court will *not* look behind a Notice of Deficiency to examine the evidence used or the propriety of [the IRS's] motives or of the administrative policy or procedure involved in making his determination . . . The underlying rationale for the foregoing is the fact that a trial before the Tax Court is a proceeding *de novo*; our determination as to a [taxpayer's] tax liability must be based on the merits of the case and not any previous record developed at the administrative level.[43]

Practical Application of Authorities

There were times when the IRS was straightforward with taxpayers, describing in its Notices of Deficiency the specific issues that it was attacking, along with the pertinent facts and tax/legal theories. The IRS does not follow that procedure any longer, at least when it comes to partnerships that donated conservation easements. Things changed when the IRS published Notice 2017-10 identifying certain charitable donations by "syndicated" partnerships as "listed transactions."

The standard approach now by the IRS in such cases is to issue a notice of final partnership administrative adjustment ("FPAA"), which is the partnership equivalent of a Notice of Deficiency, containing limited, generic, ambiguous claims. The FPAA typically alleges that (i) the partnership should get a charitable tax deduction of $0 because it supposedly failed to satisfy all requirements of Section 170, without identifying which ones, (ii) even if the partnership met all such requirements, it has not demonstrated that the conservation easement is worth more than $0, without providing a realistic alternative value, and (iii) the partnership should be subjected to one of several alternative penalties, without supplying any meaningful analysis.[44]

The IRS generates this type of nebulous FPAA because, well, it can. As explained above, Section 7522 states that an FPAA cannot be invalidated because of inadequate descriptions, the Tax Court rules affirm the general presumption that what the IRS claims in an FPAA is accurate, and *Greenberg's Express* cements the idea that the Tax Court ordi-

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[43] *Greenberg's Express, Inc. v. Commissioner*, 62 T.C. 324, 327-328 (1974).

[44] *See, e.g., Champions Retreat Golf Founders, LLC v. Commissioner*, TC Memo 2018-146. *See also* Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), pg. 7 (which directs IRS personnel to use "tiering of proposed penalties with multiple alternative positions.")

narily does not consider the actions or inactions of Revenue Agents, Appeals Officers, and other IRS personnel during the administrative phases of a tax dispute.

Because of the extreme positions taken by the IRS, combined with the vague FPAAs, it is likely that partnerships that successfully prove to the Tax Court that their charitable donations complied with Section 170 and had real value will characterize themselves as the "prevailing party" and seek cost recoupment from the IRS pursuant to Section 7430. Thus, the IRS might see the recent case, *Morreale*, as a cautionary tale. The partnerships, relying on *Morreale*, might argue that (i) the undetailed FPAAs do not adequately reveal the IRS's position, such that the Tax Court must scrutinize earlier audit records, Examination Reports and other "building blocks" on which the IRS built its case, (ii) in preparing its Examination Reports, standardized FPAAs, and Answers, the IRS ignored significant amounts of supporting data that the partnerships provided, (iii) the partnerships won on the "threshold issues" of whether the donations met Section 170 and were worth more than $0, (iv) the Tax Court will not "look granularly" at each attack advanced by the IRS in an effort to find a "saving basis," (v) the Tax Court is committed to rendering decisions that make Section 7430 a "viable path for fee awards" in appropriate situations, and (vi) the Tax Court must look to the "overall reasonableness" of the IRS's stance that every, yes every single conservation easement donation falling under Notice 2017-10 deserves an identical FPAA and a tax deduction of $0.

Conclusion

Taxpayers engaged in disputes with the IRS, involving conservation easements or otherwise, should be working with professionals at the forefront of substantive tax and procedural issues. This entails following critical new interpretations of relevant provisions, like Section 7430, in *Morreale*.