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SERIES OF TAX COURT ORDERS ALLOWING NONCONSENSUAL DEPOSITIONS BY IRS: ABERRATION OR TREND?

HALE E. SHEPPARD, ESQ.

This article explains the main data-gathering tools used by the IRS during audits, pre-trial discovery actions, limitations on depositions of potential witnesses, the conservation easement donation process, and three recent Tax Court Orders allowing the IRS to conduct nonconsensual depositions of various characters affiliated with partnerships that donated easements.

Introduction

Taxpayers in disputes with the Internal Revenue Service ("IRS") can seek judicial review in any one of three courts, but they frequently choose the Tax Court. This makes sense because the Tax Court is favorable to taxpayers in many ways. For instance, judges travel to dozens of cities throughout the year to make justice accessible, taxpayers do not need to pay the amount in dispute before fighting, the parties must work cooperatively to exchange evidence, narrow issues, and agree on facts, and pre-trial discovery demands are often minimal. Things have started changing, though, particularly when it comes to cases involving conservation easements.

This article explains the main data-gathering tools used by the IRS during audits, pre-trial discovery actions, limitations on depositions of potential witnesses, the conservation easement donation process, and three recent Tax Court Orders allowing the IRS to conduct nonconsensual depositions of various characters affiliated with partnerships that donated easements.

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Data-gathering tools during an audit

Any person (individual or entity) liable for any tax normally must file a complete, accurate and timely return with the IRS.[1] Taxpayers also must retain records in case the IRS decides to audit them.[2] Indeed, the regulations dictate that taxpayers "shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters" shown on any return.[3] With respect to accessibility and duration, taxpayers must ensure that their substantiation is kept "at all times available for inspection" by the IRS and must retain it for as long as it "may become material in the administration of any internal revenue law."[4]

The IRS enjoys broad powers in doing its job. For purposes of auditing returns, preparing returns when taxpayers fail to do so, determining liabilities of taxpayers, and collecting such liabilities, the IRS can do several things. For starters, the IRS can examine any books, records or other data that might be relevant or material. Its preferred method for carrying out such examinations is issuing Information Document Requests ("IDRs") to the taxpayer.[5] If the IRS is dissatisfied with responses to IDRs, it has the ability to send Summonses to the taxpayer. The IRS is not required to stop there, though. It can also direct Summonses during an audit to any person required to perform tax-related

acts, any person in possession, custody or control of pertinent data, or "any other person that the [IRS] may deem proper."[6]

The power to gather data by Summonses is broad, and the IRS counts on several enforcement mechanisms when it faces uncooperative taxpayers or other persons. The IRS, for example, can seek a contempt order from the appropriate District Court, ask the District Court to judicially enforce the Summons, or start a criminal proceeding.[7] For these reasons, Summonses have been labeled the "principal coercive mechanism" available to the IRS, and constitute the tacit threat behind all IDRs, requests for interviews, and other data-gathering mechanisms during an audit.[8]

The IRS might start with a more casual approach when it comes to seeking data from persons *other than* the taxpayer during the audit process; these are commonly known as third party contacts ("TPCs").[9] The IRS often begins with a letter asking, but not explicitly demanding, certain data. If this type of softer approach does not render the desired results, the IRS often resorts to Summonses, relying on its statutory power to pressure any person it "deems proper."[10]

The IRS enjoys certain advantages

When it comes to conservation easement donations, the IRS has implemented a practice of concluding audits and issuing notices of Final Partnership Administrative Adjustment ("FPAAs") and similar documents claiming that *all* partnerships should get a charitable deduction of $0 and should be severely penalized, *regardless* of the amount of pre-donation due diligence performed, strength of the conservation values, existence of multiple independent appraisals, etc. The practice also involves the IRS not specifying factual, legal, or tax reasons for its attacks. Indeed, the IRS often limits itself in the FPAAs to alleging that the partnership should get a tax deduction of $0 because "[i]t has not been established that all the requirements of Section 170 have been satisfied for the non-cash charitable contribution of a qualified conservation contribution."[11]

Why is this important? Well, among other things, there is a general presumption in federal tax disputes that determinations made by the IRS during an audit are correct.[12] In other words, when the IRS alleges in an FPAA 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 innocent-until-proven-guilty tradition, 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.[13]

One effect of this presumption is that the IRS can (i) gather all the relevant data by conducting a multi-year audit replete with interviews, property tours, IDRs, Summonses, TPCs, and document review, (ii) issue an FPAA at the end of the audit stating that the partnership should get a tax deduction of $0 and pay large penalties for unspecified reasons, and (iii) then sit back and relax at the Tax Court trial, waiting for the partnership to meet the significant burden of presenting all documents, witness testimony, and other evidence to counter the assertions in the FPAA.

Pre-trial discovery in Tax Court cases. As tedious as it may sound, learning more about the manners by which taxpayers and IRS attorneys can gather data in preparation for a Tax Court trial is critical to understanding this article.

The parties must play nice at the outset. A taxpayer often challenges an unfavorable FPAA, Notice of Deficiency, or similar document by filing a Petition with the Tax Court. After the taxpayer and the IRS attorneys have submitted all their initial pleadings

1 Section 6011(a); Treas. Reg. § 1.6011-1(a).
2 Section 6001.
3 Treas. Reg. § 1.6001-1(a).
4 Treas. Reg. § 1.6001-1(e).
5 Section 7602(a); Treas. Reg. § 301.7602-1(a); David M. Richardson et al., Civil Tax Procedure, LexisNexis, 2005, pgs. 95-104.
6 Section 7602(a); Treas. Reg. § 301.7602-1(a).
7 Section 7604(b); Section 7210.
8 David M. Richardson et al., Civil Tax Procedure, LexisNexis, 2005, pg. 96.
9 Section 7602(c)(1).
10 Section 7602(a); Treas. Reg. § 301.7602-1(a).
11 Section 6662; Section 6662A.
12 Tax Court Rule 142(a)(1).
13 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.

(*i.e.*, the Petition, Answer and Reply), they can start the pre-trial discovery process. The Tax Court is unique in this regard, requiring that the parties "informally" exchange data as much as possible *before* employing "formal" discovery tools, such as requests for admissions, requests for production of documents, interrogatories, and depositions.[14] Additionally, the parties must stipulate "to the fullest extent to which complete or qualified agreement can or fairly should be reached" all non-privileged facts and documents that are relevant to the case.[15] The Internal Revenue Manual is unambiguous in directing IRS attorneys to exhaust all informal means before upping the intensity:

The use of discovery depositions, particularly nonconsensual ones, is considerably more limited in Tax Court than in other federal courts capable of resolving tax disputes.

> The Tax Court is insistent that the parties use informal efforts to obtain needed information for the preparation of the case for trial. The court expects the parties to discuss, deliberate, and exchange ideas, thoughts and opinions on an informal basis before resorting to the [formal] methods specified in the rules. Short cuts to the use of formal discovery [including nonconsensual depositions] will not be tolerated.[16]

General discovery rules. Normally, the parties carry out the so-called "discovery" process by issuing interrogatories, requests for admissions, and requests for production of documents.[17] The parties enjoy significant latitude in making inquiries; they can seek any data that is non-privileged and that "is relevant to the subject matter involved in the pending case."[18] The fact that the specific data sought by the parties could not be introduced as evidence during a Tax Court trial is not an impediment, as long as such data "appears reasonably calculated to lead to discovery of admissible evidence."[19]

The use of discovery tools is not limitless, of course. The Tax Court can control the frequency or extent of data requests if it determines that (i) the data sought is unreasonably cumulative or duplicative, (ii) the party seeking the data could obtain it more conveniently from another source, (iii) the party seeking the data has already had "ample opportunity" to obtain it, or (iv) the request is "unduly burdensome or expensive," keeping in mind the needs of the case, the amount in dispute with the IRS, the limited resources of the parties, and the importance of the issues at stake in the Tax Court litigation.[20]

Special rules exist with respect to experts. Parties generally cannot use discovery tools to obtain draft versions of reports prepared by experts.[21] Moreover, opposing parties cannot get access to communications between the attorneys and their expert witnesses, unless they relate to how much the experts are charging or to data, facts, or assumptions that the attorneys supplied the experts for use in preparing their reports.[22] Finally, when it comes to non-testifying expert witnesses (*i.e.*, those hired exclusively to assist in preparation for trial), parties ordinarily may not use discovery tools to learn the facts known to, or opinions held by, such witnesses.[23] This general rule might be waived, though, if a party can demonstrate to the Tax Court that there are "exceptional circumstances" that make it impracticable for the party to obtain facts and opinions on the same subject in some other way.[24]

Short history on depositions. Beginning in 1974, the Tax Court allowed "evidentiary depositions" (*i.e.*, those designed to obtain testimony before trial because of concerns that a witness might be unavailable to testify later at trial because of age, sickness, mental state, imprisonment, foreign residency, etc.). It did not permit "discovery depositions" (*i.e.*, those conducted to gather evidence, attain sworn statements to impeach witnesses later during cross-examination at trial, etc.). A few years later, in 1979, the Tax Court changed its rules to permit discovery depositions, but only if all parties consented. The rules eventually evolved to allow nonconsensual discovery depositions of various persons. Even after such expansion, however, the use of discovery depositions, particularly nonconsensual ones, is considerably more limited in Tax Court than in other federal courts capable of resolving tax disputes. This limitation was "intentional and was designed to avoid excessive and abusive use of discovery depositions."[25]

Focus on nonconsensual depositions. Parties involved in a Tax Court dispute normally can take, or attempt to take, depositions of a party, a non-party witness, or an expert witness. This article focuses on nonconsensual discovery depositions, as does the summary below.[26]

Conducting nonconsensual depositions is "an extraordinary method of discovery," which can *only* be used in Tax Court disputes where (i) a party, non-party witness, or expert witness, (ii) can give testimony, or possesses documents, information, or other discoverable items, and (iii) such testimony and/or items cannot "practicably" be obtained through other types of discovery requests, including consensual depositions.[27] Procedural variations exist depending on whether the proposed deposition involves a party, non-party witness, or expert witness, but the basic steps are as follows. The party seeking the deposition must send notice of the deposition, describing the reasons for the inquiry, the parameters, the materials to bring, and

other details. The target or the affected party has an opportunity to lodge an objection with the Tax Court. Then, the Tax Court rules on the matter, with or without the help of legal briefing and a hearing.[28]

Consequences of not participating. Not participating in a deposition can trigger severe consequences; the Tax Court is broadly authorized to issue Orders that are "just" to sanction the violation. Such Orders might establish certain facts and issues as true, prevent the disobedient party from supporting claims or defenses during litigation, strike portions of the Tax Court pleadings, dismiss aspects of a case, suspend further proceedings until the deposition has been held, or render a default judgment against the defiant party.[29] In addition to issuing such Orders, the Tax Court can hold the recalcitrant witness in contempt of court and liable for all pertinent expenses.[30]

Earlier attempts to compel depositions

The Tax Court has addressed issues surrounding nonconsensual depositions before. For example, in *K&M La Botica Pharmacy, Inc. v. Commissioner*, a taxpayer attempted to force one of his former employees, a non-party witness, to participate in a pre-trial deposition.[31] The purported reasons for the deposition were to determine the veracity of prior allegations, identify other potential witnesses, and ascertain whether the witness had any other relevant information. The Tax Court ruled that such grounds were insufficient under the relevant rules to merit a nonconsensual deposition. In doing so, the Tax Court emphasized that a nonconsensual deposition constitutes "an extraordinary method of discovery," which should only be used when (i) a compelling justification exists, (ii) it is designed to obtain specific and precise factual information that is essential to a case, (iii) the individual to be questioned is the "sole source" of such information, (iv) it will not serve as a substitute for later cross-examining the witness at trial, and (v) the party seeking the deposition did not have prior opportunities to access the information.[32]

Three recent tax court orders

The Tax Court issued three Orders by three different judges in less than one month in late 2021, broadly interpreting the rules regarding nonconsensual depositions in the context of conservation easement disputes. Before getting to the Orders, though, it is necessary to supply an overview of easement donations and key characters.

Overview of conservation easement donation process. Taxpayers who own undeveloped real property have several choices. They might (i) hold the property for investment purposes, selling it when it appreciates sufficiently, (ii) determine how to maximize profitability from the property and do that, regardless of negative effects on the local environment, community, or economy, or (iii) voluntarily restrict certain future uses of the property, such that it is protected forever for the benefit of society. The third option, known as donating a "conservation easement," not only achieves environmental protection, but also triggers tax deductions for donors.[33] Taxpayers cannot place an easement on just any property and claim a tax deduction; they must demonstrate that the property has at least one acceptable "conservation purpose."[34] Common conservation purposes include preserving land for public recreation or education, safeguarding a relatively natural habitat for plants and animals, maintaining open space for scenic enjoyment by the general public, and utilizing property pursuant to a government conservation policy.[35]

Taxpayers memorialize the donation by filing a Deed of Conservation Easement or similar document ("Deed"). In preparing the Deed, taxpayers often coordinate with a land trust to identify certain

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14 *Branerton Corp. v. Commissioner*, 61 T.C. 691 (1974).
15 Tax Court Rule 91(a)(1).
16 Internal Revenue Manual § 35.4.3.2 (08-11-2004).
17 Tax Court Rule 70(a)(1).
18 Tax Court Rule 70(b).
19 Tax Court Rule 70(b).
20 Tax Court Rule 70(c)(1).
21 Tax Court Rule 70(c)(4)(A).
22 Tax Court Rule 70(c)(4)(B).
23 Tax Court Rule 70(c)(4)(C).
24 Tax Court Rule 70(c)(4)(C).
25 Gerald A. Kafka and Rita A. Cavanagh. Litigation of Federal Civil Tax Controversies. Second Edition. Student Edition. Warren, Gorham & Lamont (1997), pgs. 6-25 and 6-26.
26 Tax Court Rule 74(a). This article does not address taking depositions for purposes of perpetuating evidence that might not otherwise be available at time of trial. *See* Tax Court Rules 80 through 84.
27 Tax Court Rule 74(c)(1)(B).
28 Tax Court Rule 74(c)(2),(3), and (4).
29 Tax Court Rule 104(c)(1), (2) and (3).
30 Tax Court Rule 104(c)(4).
31 *K&M La Botica Pharmacy, Inc. v. Commissioner*, T.C. Memo 2001-33.
32 *K&M La Botica Pharmacy, Inc. v. Commissioner*, T.C. Memo 2001-33; *See also DeLucia v. Commissioner*, 87 T.C. 804 (1986).
33 Section 170(f)(3)(B)(iii); Treas. Reg. § 1.170A-7(a)(5); Section 170(h)(1); Section 170(h)(2); Treas. Reg. § 1.170A–14(a)Treas. Reg. § 1.170A–14(b)(2)
34 Section 170(h)(4)(A); treglink>; S. Rept. 96–1007, at 10 (1980).
35 Section 170(h)(4)(A); Treas. Reg. § 170A–14(d)(1).

limited activities that can continue on the property after the donation, without interfering with the Deed and without prejudicing the conservation purposes ("Reserved Rights").[36] The IRS will not allow the tax deduction stemming from a conservation easement, unless the taxpayer obtains, shortly before making the donation, documentation establishing the condition and characteristics of the property ("Baseline Report").[37]

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The value of the conservation easement is the fair market value ("FMV") of the property at the time of the donation.[38] The term FMV ordinarily means the price on which a willing buyer and willing seller would agree, if neither party were obligated to participate in the transaction, and if both parties had reasonable knowledge of the relevant facts.[39] The best evidence of the FMV of an easement would be the sale price of other conserved properties that are comparable in size, location, etc. The IRS recognizes, though, that it is difficult, if not impossible, to find them.[40] Consequently, appraisers often must use the before-and-after method instead. This means that they must determine the highest and best use ("HBU") of the property *and* the corresponding FMV twice. First, the appraisers calculate the FMV as if the property were put to its HBU, which generates the "before" value. Second, the appraisers identify the FMV, taking into account the restrictions on the property imposed by the conservation easement, which creates the "after" value.[41] The difference between the "before" and "after" values of the property, with certain adjustments, produces the amount of the donation.

A property's HBU is the most profitable use for which it is adaptable and needed in the reasonably near future.[42] The HBU must also be physically possible, legally permissible, financially feasible, and maximally productive.[43] Importantly, valuation in the easement context does not depend on whether the owner has actually put the property to its HBU in the past.[44] The HBU can be *any* realistic potential use of the property.[45] Common HBUs are construction of a residential community, creation of a mixed-use development, mining of all types, and establishment of a solar energy farm.

Claiming the tax deduction from an easement donation with the IRS is surprisingly complicated. It involves a significant amount of actions and documents. Among other things, the taxpayer must obtain a Qualified Appraisal from a Qualified Appraiser, demonstrate that the land trust is a Qualified Organization, obtain a Baseline Report, complete a Form 8283 (Noncash Charitable Contributions), file a timely tax return enclosing Form 8283 (Noncash Charitable Contributions) and other items, and receive from the land trust an appropriate written acknowledgment of the donation.[46]

Key characters. There is no typical conservation easement donation because all properties, charitable motives, valuation methods, HBUs, and other circumstances are unique in each case. Nevertheless, *solely* for purposes of simplifying matters to understand the scope of the recent Tax Court Orders about nonconsensual depositions, the key characters in a conservation easement donation might be described as follows:

- The original landowner, who initially holds the property on which a conservation easement is later placed;
- The organizer, who identifies the potential property, hires multiple experts to conduct due diligence regarding the property and its possible uses, engages a laundry list of specialized professionals to complete various projects, and locates partners willing to invest;
- The transactional attorney, who forms the necessary partnerships or other entities, analyzes legal, tax and regulatory issues, prepares opinion letters, drafts Private Placement Memoranda or similar materials describing the potential investment, and creates legal documents to effectuate transactions;
- The appraiser, who prepares the Qualified Appraisal, often with assistance from construction, mining, zoning, environmental, transportation, cost and other experts;
- The land trust, which frequently prepares the Baseline Report, the Deed and Form 8283, receives the easement donation, and then protects the property forevermore;
- The accountant, who prepares and files all required tax and information returns; and
- The partners, who receive allocations of the charitable tax deduction thanks to their indirect ownership interest in the partnership that donates the conservation easement.

The actual participants in each situation vary significantly, as do their precise roles. The preceding constitutes merely a simplified, general, and partial picture.

Green Valley Investors, LLC – focus on original landowner. The Tax Court previously ruled in favor of the IRS on one Motion for Summary Judgment in *Green Valley Investors, LLC v. Commissioner*, thereby concluding that the partnerships were entitled to charitable deductions of $0.[47] Thus, the remaining issues centered on penalties, including whether the partnerships had any defenses to them.[48]

The partnerships alleged that they should escape penalties, despite the disallowance of the easement-related deduction, because they (i) had "reasonable cause" for any tax underpayments, (ii) obtained "qualified appraisals," (iii) reasonably relied on such appraisals, (iv) hired qualified appraisers, and (v) conducted their own "good faith investigation" of the values of the easements. To prepare its case on these and other matters, the IRS issued four sets of "informal" discovery requests. Among other things, the IRS asked about the role of the original landowner, who might have also served as an organizer, and about his relationship with the appraisers.

The partnerships did not answer the questions to the satisfaction of the IRS in response to the informal discovery requests, so it asked for a consensual deposition of the original landowner. The partnerships rebuffed the IRS, so it took another approach, this time seeking an "informal interview," one without stenographers, videographers, sworn statements, etc. The partnership balked again, so the IRS filed a Motion with the Tax Court, seeking a nonconsensual deposition. According to the IRS, the deposition was necessary because previous informal discovery attempts were unfruitful, the original landowner would be the principal witness at trial, and he had unique, critical information. The IRS emphasized in this regard that the original landowner formed and managed the relevant partnerships, structured the investment, solicited valuations from the appraisers, obtained legal and tax advice, arranged the donation to the land trust, engaged the promoters, and possessed "exclusive knowledge of the facts relevant to any penalty defenses."[49]

The Tax Court first turned to its own rules, as explained earlier in this article. It noted that the IRS was seeking information that relates to the "central issue" remaining in the cases; that is, whether the knowledge, understanding and personal beliefs of the original landowner at the time of the pertinent events support certain defenses to penalties. The Tax Court concluded that a nonconsensual deposition of the original landowner was "reasonably calculated" to lead to the discovery of admissible evidence.[50] The Tax Court next determined that the IRS could not "practicably" obtain the evidence sought from the original landowner by some method other than a nonconsensual deposition. In reaching this decision, the Tax Court underscored that the partnership provided vague or deficient responses to four informal discovery requests, rejected the idea of a consensual deposition, and likewise declined the invitation by the IRS to schedule an informal interview.[51]

Lastly, the Tax Court turned to the factors identified in *K&M La Botica Pharmacy, Inc. v. Commissioner*. It first explained that the IRS showed a specific and compelling need for the deposition, which was to gather information about whether the original landowner acted reasonably and in good faith in hiring and relying on the appraisers and how his professional experience in the real estate and mining industries affected this analysis. Second, the Tax Court determined that the IRS planned for the deposition to function as more than a mere substitute for conducting a cross-examination of the original landowner at trial. It highlighted the fact that the original landowner had "direct knowledge" related to penalties, the only remaining issue in dispute, and had yet to clarify his history in the real estate and mining industry. Third, as explained in the preceding paragraph, the Tax Court found that the IRS did not have a prior chance to get testimony from the organizer/original landowner.[52]

Oconee Landing Property, LLC – focus on appraisers. The discovery dispute in *Oconee Landing Property,*

[36] Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), pg. 23; *see also* Treas. Reg. § 1.170A-14(b)(2); Treas. Reg. § 1.170A-14(e)(2) and (3).

[37] Treas. Reg. § 1.170A-14(g)(5)(i).

[38] Section 170(a)(1); Treas. Reg. § 1.170A-1(c)(1).

[39] Treas. Reg. § 1.170A-1(c)(2).

[40] Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 1/24/2018), pg. 43.

[41] *Ibid*.

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

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

[44] *Esgar Corp. v. Commissioner*, 744 F.3d 648, 657 (10th Cir. 2014).

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

[46] *See* Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 1/24/2018), pgs. 24-31; IRS Publication 1771, Charitable Contributions – Substantiation and Disclosure Requirements; IRS Publication 526, Charitable Contributions; Section 170(f)(8); Section 170(f)(11); Treas. Reg. § 1.170A-13; Notice 2006-96; TD 9836.

[47] *Green Valley Investors, LLC v. Commissioner*, Tax Court Docket Nos. 17379-19, 17380-19, 17381-19, and 17382-19, Order, May 27, 2021.

[48] *Green Valley Investors, LLC v. Commissioner*, Tax Court Docket Nos. 17379-19, 17380-19, 17381-19, and 17382-19, Order, Dec. 1, 2021.

[49] *Green Valley Investors, LLC v. Commissioner*, Tax Court Docket Nos. 17379-19, 17380-19, 17381-19, and 17382-19, Order, Dec. 1, 2021, pgs. 2-3.

[50] *Green Valley Investors, LLC v. Commissioner*, Tax Court Docket Nos. 17379-19, 17380-19, 17381-19, and 17382-19, Order, Dec. 1, 2021, pg. 4.

[51] *Green Valley Investors, LLC v. Commissioner*, Tax Court Docket Nos. 17379-19, 17380-19, 17381-19, and 17382-19, Order, Dec. 1, 2021, pgs. 4-5.

[52] *Green Valley Investors, LLC v. Commissioner*, Tax Court Docket Nos. 17379-19, 17380-19, 17381-19, and 17382-19, Order, Dec. 1, 2021, pg. 5.

LLC v. Commissioner centered on the two relevant appraisers.[53] The partnership in question donated a conservation easement in 2015. Before doing so, it received a "restricted appraisal report," which allegedly was used in connection with marketing the partnership to potential investors, and later received a "final appraisal report," which was submitted to the IRS along with the tax return. The IRS audited the donation, of course. It eventually asserted in an FPAA that the partnership was entitled to a deduction of $0 and should pay one of a series of alternative penalties, starting with the "gross valuation penalty" equal to 40 percent of the tax underpayment. The partnership challenged these initial assertions by filing a Petition with the Tax Court.

The IRS attorneys requested during the informal discovery process that the appraisers produce certain documents and participate in informal interviews. They declined. The IRS attorneys next sent the appraisers notices of depositions. They objected. The IRS attorneys, therefore, elevated matters by filing with the Tax Court a Motion to compel the appraisers to participate in the nonconsensual depositions. The appraisers opposed the Motion and solicited a Protective Order.

The Tax Court began by noting that the appraisers were considered "non-party witnesses," because they were neither the taxpayer nor an expert witness hired to assist the taxpayer prepare for trial, craft an expert report, and/or testify at trial. Based on their status, the Tax Court explained that nonconsensual depositions can be used only when the information sought is relevant, not privileged, and unattainable through informal consultation or communication. The Tax Court then identified four issues that the case needed to address, namely, the proper value of the conservation easement, whether the appraisers are Qualified Appraisers, whether the "final appraisal report" constitutes a Qualified Appraisal, and whether the partnership can demonstrate that any inaccuracies on the tax return were attributable to reliance in good faith on advice from qualified, informed professionals.[54]

It was "clear" to the Tax Court that the appraisers possessed relevant, non-privileged information regarding at least some of the four issues described above. For instance, with respect to valuation, the Tax Court explained that it might be relevant whether the appraisers had general knowledge about any prior valuations of the property and whether they had specific awareness of the transaction in December 2015, just days before the charitable donation valued at $20.7 million, whereby an entity purchased 97 percent of the partnership for $2.4 million. The answers to these inquiries, emphasized the Tax Court, might also affect the issue of whether the partnership relied on the appraisers in good faith. The Tax Court acknowledged that whether the appraisers met the Qualified Appraiser standards set forth in the Internal Revenue Code, corresponding regulations, and IRS administrative pronouncements was largely an objective question, gleaned from reviewing the appraisals themselves. However, it noted that other facts, only obtainable via depositions, might also shed light on the issue. For example, an individual is not a Qualified Appraiser if the donor knew of facts that would cause a reasonable person to believe that the appraiser had overstated the value, or if the donor and the appraiser made an agreement about the value. The Tax Court stated that communications between the appraisers, the original landowners, the organizers and/or their representatives might address these issues.[55]

Regarding the matter of "reasonable cause" for any inaccuracies on the relevant tax return, the regulations direct the Tax Court to consider the relationship between the purchase price of the property and its appraised value, the circumstances under which the appraisal was obtained, and the relationship between the taxpayer and the appraisers. The Tax Court added to that list the timeline of the work by the appraisers and how it interfaced with the marketing materials, such as the Private

[53] *Oconee Landing Property, LLC v. Commissioner*, Tax Court Docket No. 11814-19, Order, Nov. 24, 2021.

[54] *Oconee Landing Property, LLC v. Commissioner*, Tax Court Docket No. 11814-19, Order, Nov. 24, 2021, pg. 3.

[55] *Oconee Landing Property, LLC v. Commissioner*, Tax Court Docket No. 11814-19, Order, Nov. 24, 2021, pgs. 3-4.

[56] *Oconee Landing Property, LLC v. Commissioner*, Tax Court Docket No. 11814-19, Order, Nov. 24, 2021, pg. 4.

[57] *Oconee Landing Property, LLC v. Commissioner*, Tax Court Docket No. 11814-19, Order, Nov. 24, 2021, pg. 5.

[58] *Oconee Landing Property, LLC v. Commissioner*, Tax Court Docket No. 11814-19, Order, Nov. 24, 2021, pg. 5.

[59] *Oconee Landing Property, LLC v. Commissioner*, Tax Court Docket No. 11814-19, Order, Nov. 24, 2021, pg. 5.

[60] *Oconee Landing Property, LLC v. Commissioner*, Tax Court Docket No. 11814-19, Order, Nov. 24, 2021, pg. 5.

[61] *Picayune Pearl Aggregates, LLC v. Commissioner*, Tax Court Docket No. 7045-19, Order, Nov. 23, 2021. The author of this article and his firm represent the taxpayer in this Tax Court case.

[62] *Picayune Pearl Aggregates, LLC v. Commissioner*, Tax Court Docket No. 7045-19, Order, Nov. 23, 2021, pg. 2.

[63] Tax Court Rule 70(c)(4)(C).

[64] Tax Court Rule 70(c)(4)(C); Federal Rule of Civil Procedure 26(b)(4)(D).

[65] *Picayune Pearl Aggregates, LLC v. Commissioner*, Tax Court Docket No. 7045-19, Order, Nov. 23, 2021. pg. 2, Footnote 2.

Placement Memorandum, sent to potential partners. The Tax Court repeated that communications between the appraisers, the original landowners, the organizers and/or their representatives might be elucidating.[56] For the reasons described above, the Tax Court authorized the nonconsensual depositions of the appraisers. To make matters worse from the perspective of the appraisers, the Tax Court denied their request for a Protective Order. Specifically, the Tax Court rejected their requests that the depositions be limited to certain topics, the transcripts of the depositions be sealed and not available to the general public, and they get paid at their normal hourly rate for participating.[57] In doing so, the Tax Court noted, gratuitously perhaps, that the appraisers received substantial fees for their work, knew that litigation might ensue, and "cannot plausibly express surprise" that the IRS attorneys wish to depose them before trial.[58] The Tax Court also indicated that it would not mandate any special procedure to implement an "ethical wall" designed to prevent the IRS from using any data gathered during the depositions now against the appraisers in other areas later. The Tax Court said that it was satisfied solely with assurances by the IRS that it would "comply with any and all applicable rules regarding the permissible uses of information gathered through the depositions."[59] Softening a bit, the Tax Court explained that the depositions would be taken by video-conference to reduce costs, the attorneys could negotiate their length, and the appraisers could assert privilege claims or other objections to any specific questions.[60]

Picayune Pearl Aggregates, LLC – focus on mining engineers. The conflict in *Picayune Pearl Aggregates, LLC v. Commissioner* focused on mining engineers, who did not prepare the appraisal supporting the charitable donation deduction, who did not sign the Form 8283 or any other document as an appraiser, but who provided opinions about mineral resources on the relevant property that the appraiser considered in doing his own analysis.[61] Without going into detail, the Tax Court succinctly stated that the two mining engineers "were involved in the authorship" of certain reports used by the appraiser and a nonconsensual deposition to learn more about their work was "proper."[62] Interestingly, the Tax Court acknowledged in a footnote that the mining engineers served two roles. They first were non-party witnesses who assisted the appraiser to a certain degree. They were also non-testifying experts (*i.e.*, consulting experts) hired by the partnership for purposes of trial preparation, who ordinarily would be exempt from depositions.[63] Indeed, the applicable Tax Court Rule and Federal Rule of Civil Procedure state that a party to the litigation, like the IRS, ordinarily cannot conduct depositions of consulting experts to "discover facts known or opinions held by" such experts "except on a showing of exceptional circumstances under which is it impracticable for the [IRS] to obtain facts or opinions on the same subject by other means."[64] Without analysis, without any mention of the standards for meeting the exception, and without imposing any specific limitations on the subject matter that could be covered in the depositions, the Tax Court held that such duality did not protect the mining engineers because the IRS attorneys supposedly were seeking to depose them solely in their capacities as non-party witnesses.[65]

Conclusion

The pertinent rules and Tax Court precedent establish that taking nonconsensual depositions of non-party witnesses is an "extraordinary" discovery method, which is only appropriate in very limited circumstances. Notwithstanding this high hurdle, the Tax Court has recently issued three Orders allowing the IRS to get pre-trial testimony from various characters affiliated with conservation easements, namely, an original landowner, an appraiser, and a mining engineer. It is uncertain at this early stage whether this practice (of both the IRS seeking depositions and the Tax Court permitting them) is unique to conservation easement disputes or will become widespread. What is clear, though, is that taxpayers engaged in Tax Court litigation need to be aware of this development and plan accordingly. ■