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# ANALYZING OBSTACLES FOR THE IRS IN APPROACHING PARTNERS DURING PARTNERSHIP TAX DISPUTES

HALE E. SHEPPARD

This article explains the relevant procedural matters, provides an overview of the easement donation process and its key characters, and describes four major problems that the IRS faces in approaching individual partners using recent court orders to illustrate the situation.

When engaged in a tax dispute with a partnership, the IRS logically wants to gather as much data as possible from all sources, including the partners. A major impediment for the IRS is that its ability to contact partners directly (during an audit, an administrative appeal, or in preparation for Tax Court litigation) is limited or prohibited altogether. However, this has not stopped the IRS from trying, particularly when it comes to cases involving conservation easement donations. This article explains the relevant procedural matters, provides an overview of the easement donation process and its key characters, and describes four major problems that the IRS faces in approaching individual partners using recent court orders to illustrate the situation.

## Essential Background on Procedural Matters

Readers need some background about several aspects of tax procedure in order to appreciate this article.

**Filing and record-keeping duties.** A person liable for any tax normally must file a complete, accurate and timely return using the forms issued by the IRS.[1] When it comes to domestic partnerships, persons must file Forms 1065 (U.S. Return of Partnership Income) with the IRS.[2]

Taxpayers must also retain records just in case the IRS decides to audit them.[3] 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.[4] 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."[5]

### Data-gathering tools during an audit

The IRS enjoys broad powers. For the 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.[6] The IRS's preferred method for carrying out such examinations is issuing Information Document Requests (IDRs) to the taxpayer.[7] If the IRS is dissatisfied with responses to IDRs, it has the ability to send a summons to the taxpayer. The IRS

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is not required to stop there. It can also direct a summons 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."[8]

The power to gather data by summons is broad, and the IRS counts on several enforcement mechanisms when it faces uncooperative taxpayers or other persons. For example, the IRS can seek a contempt order, ask the District Court to judicially enforce the summons, or start a criminal proceeding.[9] For these reasons, a summons is the "principal coercive mechanism" available to the IRS and constitutes the tacit threat behind all IDRs, requests for interviews, and other data-gathering mechanisms used during an audit.[10]

The IRS often starts with a more casual approach when it comes to persons other than the taxpayer during an audit. This is called making a third-party contact (TPC).[11] The IRS frequently begins with letters asking for certain data, likely hoping that the recipients of such letters cooperate out of fear, ignorance, or sense of duty. If this softer maneuver does not garner the desired results, the IRS often resorts to a summons, relying on its statutory power to pressure any person it "deems proper."[12]

**The third option, known as donating a "conservation easement," not only achieves environmental protection but also triggers tax deductions for donors.**

**Leadership of partnerships during tax disputes.** Partnership items (such as partnership income, gain, deductions, losses, credits, etc.) pass through a partnership and are reported on the income tax returns of the partners.[13] The partnership must file an annual Form 1065 that indicates the partners to which the items flowed, but the entity itself has no tax liability. In other words, a partnership is a conduit, not a separate taxable entity.

There was no procedure in place for many years allowing the IRS to conduct a partnership-level audit. Therefore, the IRS was forced to scrutinize the tax positions taken by each of the partners. This changed in 1982 when Congress passed the Tax Equity and Fiscal Responsibility Act (TEFRA).[14] This legislation introduced partnership-level audit procedures, which permitted the IRS to audit the partnership itself, determine the appropriate adjustments, and then notify the partners of the tax effects of such adjustments based on their respective ownership interests in the partnership.[15] In short, TEFRA enabled the IRS to focus its audits on the partnership, not the partners themselves.

The representative for a TEFRA partnership is its tax matters partner (TMP). Selecting the proper TMP is pivotal as the TMP has special rights to conduct the partnership audit, extend the assessment period, file a refund claim, settle the proposed partnership adjustments with the IRS, and select the court before which any tax litigation with the IRS will occur.[16] The TMP often hires tax defense attorneys to represent the partnership.

The TEFRA rules were repealed in 2015 and replaced by a new regime enacted under the Bipartisan Budget Act (BBA).[17] The spokesperson and principal decision-maker for BBA partnerships is known as the partnership representative, instead of the TMP.[18] Because most of the sources cited in this article reference the TMP, this article exclusively uses the term TMP for the sake of clarity. However, the issues associated with the IRS directly contacting partners are applicable to both TEFRA partnerships and BBA partnerships.

**Representation by attorneys.** Taxpayers under audit, including partnerships that donate conservation easements, have the right to hire attorneys or other tax professionals to defend them.[19] Such professionals generally have authority to handle all aspects of the tax dispute, including all communications with the IRS.[20] Provided that the tax professionals have submitted a proper Form 2848 (Power of Attorney), the IRS must provide them copies of all notices, letters, reports, and any other written communications directed to the taxpayer.[21]

## Overview of conservation easement donations

To grasp the procedural and strategic issues discussed later in this article, readers also need to understand the basics of conservation easement donations and their key characters.

**A peek at the process.** Taxpayers who own undeveloped real property have several choices. They might hold the property for investment purposes, hoping it appreciates significantly in value; determine how to maximize profitability from the property and do that, regardless of negative effects on the local environment, community, or economy; or 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.[22]

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."[23] 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 public, and utilizing property pursuant to a government conservation policy.[24]

Taxpayers memorialize the donation by filing a deed of conservation easement or similar document. In preparing the deed, taxpayers often coordinate with a land trust to identify certain limited activities that can continue on the property after the donation without prejudicing the conservation purposes.[25]

The IRS will not allow the tax deduction stemming from a conservation easement unless the taxpayer obtains documentation establishing the condition and characteristics of the property ("baseline report") shortly before making the donation.[26]

The value of the conservation easement is the fair market value ("FMV") of the property at the time of the donation.[27] The term FMV ordinarily refers to 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.[28] 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. However, the IRS recognizes that it is difficult, if not impossible, to find them.[29] 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. The appraisers must first calculate the FMV as if the property had been put to its HBU, which generates the "before" value. The appraisers then identify the FMV, taking into account the serious restrictions on the property imposed by the conservation easement, which creates the "after" value.[30] The difference between the "before" and "after" values of the property, with certain adjustments, produces the amount of the donation.

Claiming the tax deduction from an easement donation is surprisingly complicated. It involves a significant number 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 qrganization, obtain a baseline report, complete a Form 8283 (noncash charitable contributions), file a timely Form 1065 with all necessary enclosures and disclosures, and receive a written acknowledgment of the donation from the land trust.[31]

**Key characters.** There is no typical conservation easement donation as all properties, charitable motives, conservation features, valuation methods, HBUs, and other circumstances are unique in each case. Nevertheless, in order to simplify matters for this article, the key characters in a conservation easement donation are 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 dili-

1 IRC Section 6011(a); Treas. Reg. Section § 1.6011-1(a).
2 IRC Section 6031(a); Treas. Reg. Section § 1.6031(a)-1(a)(1).
3 IRC Section 6001.
4 Treas. Reg. Section § 1.6011-1(a).
5 Treas. Reg. Section § 1.6011-1(e).
6 IRC Section 7602(a).
7 *Ibid.*; Treas. Reg. § 301.7602-1(a); Richardson, D. M., Borison, J., and Johnson, S., *Civil Tax Procedure* (LexisNexis, 2005): 95–104.
8 IRC Section 7602(a); Treas. Reg. § 301.7602-1(a).
9 IRC Section 7604(b); IRC Section 7210.
10 *Op. cit.* note 7, p. 96.
11 IRC Section 7602(c)(1).
12 *Op. cit.* note 7.
13 IRC Section 6231(a)(3); Treas. Reg. § 301.6231(a)(3)-1.
14 Public Law 97-248.
15 IRC Sections 6221–6234.
16 IRC Section 6226(a); Grunberger, A., Appointing the right tax matters partner benefits all partners, *Taxation for Lawyers* 24, no. 1 (July/Aug. 1995).
17 Bipartisan Budget Act of 2015, Public Law No. 114-74.
18 IRC Section 6223(a); Treas. Reg. § 301.6223-1.
19 IRC Section 7521(c).
20 *Ibid*.
21 Treas. Reg. § 601.506(a).
22 IRC Section 170(f)(3)(B)(iii); Treas. Reg. § 1.170A-7(a)(5); IRC Section 170(h)(1); IRC Section 170(h)(2); Treas. Reg. § 1.170A–14(a); Treas. Reg. § 1.170A–14(b)(2).
23 IRC Section 170(h)(4)(A); Treas. Reg. § 170A–14(d)(1) S. Rept. 96–1007, at 10 (1980).
24 *Ibid*.
25 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).
26 Treas. Reg. § 1.170A-14(g)(5)(i).
27 IRC Section 170(a)(1); Treas. Reg. § 1.170A-1(c)(1).
28 Treas. Reg. § 1.170A-1(c)(2).
29 Internal Revenue Service, *Conservation Easement Audit Techniques Guide* (Rev. 1/24/2018), pg. 43.
30 *Ibid.*
31 *Op. cit.* note 29; see also IRS Publication 1771, *Charitable Contributions – Substantiation and Disclosure Requirements*; IRS Publication 526, *Charitable Contributions*; IRC Section 170(f)(8); IRC Section 170(f)(11); Treas. Reg. § 1.170A-13; Notice 2006-96; TD 9836.

gence regarding the property and its possible uses, engages in 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;

**There is no typical conservation easement donation as all properties, charitable motives, conservation features, valuation methods, HBUs, and other circumstances are unique in each case.**

- The property partnership ("PropCo"), which normally receives the relevant property as a capital contribution from the original landowner which ultimately donates the conservation easement to the land trust and claims a charitable tax deduction with the IRS;
- The investment partnership ("InvesCo"), which purchases nearly all the membership interests in PropCo from the original landowner before the PropCo donates the conservation easement to the land trust;
- The direct individual partners, who own a small percentage of membership interests in PropCo from the outset, who do not sell such interests, and who receive minor allocations of the charitable tax deduction because of their interests in PropCo;
- The indirect individual partners, who own interests in InvesCo and who receive allocations of the charitable tax deduction thanks to their indirect interest in PropCo; and
- The accountants, who prepare and file all required tax and information returns for PropCo, InvesCo, direct individual partners, and indirect individual partners.

## Problem 1: Seeking data from partners during an audit

As explained in the introduction to this article, a common tactic of the IRS nowadays is to seek data from individual indirect partners during the audit.

The IRS has provided guidance about notice procedures under former Section 7602 when partnerships are involved. In Chief Counsel Advice 200109047, the IRS determined that, in the context of a TEFRA partnership audit, the partners and the partnership are treated as one. The IRS published the following unambiguous conclusion:

> With respect to a TEFRA partnership, contacts made with any partner are not Section 7602(c) contacts because they are considered the equivalent of contacting the partnership.

Chief Counsel Advice 200109047 then provided more color on this point, as follows:

> Contacts made with the partners of a TEFRA partnership are not treated as contacts with persons other than the taxpayer. Since a partnership is not a natural person, it can only speak or act through authorized agents or representatives. Similarly, contacts with a partnership generally must be through a natural person, i.e., an individual. By virtue of their owning a partnership interest, the partners are afforded certain rights and charged with certain responsibilities relating to the partnership by state laws such as the Uniform Partnership Act and the Uniform Limited Partnership Act, as well as under the partnership agreement that they entered into with respect to the specific partnership of which they are a partner. In addition, in TEFRA partnerships, each partner has the right to participate in any administrative proceeding relating to the determination of the proper tax treatment of partnership items at the partnership level . . . Hence, the partners may be viewed as being in privity with the partnership, at least for purposes of the administrative tax proceeding. Consequently, a contact made with any partner of a TEFRA partnership should be treated as a contact of the partnership, rather than as a [TPC].[32]

The Internal Revenue Manual fortifies the IRS guidance contained in Chief Counsel Advice 200109047. It explains that "[c]ontacts made with any partner of a TEFRA partnership are not [TPCs] since they are considered contacts with the partnership."[33]

Chief Counsel Advice 200109047 and the Internal Revenue Manual create a procedural problem for the IRS. Specifically, partners are considered part of the partnership, a partnership is represented by the TMP, the TMP ordinarily hires tax counsel to defend the partnership, and such counsel generally has the right to attend all meetings, answer all questions, provide all data, and receive all notices for the partnership. Thus, attempts by a revenue agent to contact a partner directly during an audit violates the IRS's own guidance.

## Problem 2: Seeking data from partners during an audit

What if the IRS were to change its tune and take the position that despite what it previously said in Chief Counsel Advice 200109047 and the Internal Revenue Manual, individual indirect partners should not be treated as part of the partnership, but rather as third parties? Well, the IRS would then encounter a new problem.

The prior version of Section 7602 states that the IRS generally cannot contact any person, other than the taxpayer, with respect to the determination or collection of a tax liability, without providing "reasonable notice in advance" to the taxpayer.[34] In addition to notifying taxpayers in a timely manner, the legislative history, applicable regulations, Internal Revenue Manual, and case law all indicate that the IRS must first seek the relevant data from the taxpayer under audit (including a partnership) before contacting any other persons. This article looks at each of these sources separately.

First, in introducing Section 7602, Congress was concerned that heavy-handed behavior by the IRS could irreparably harm taxpayers. Therefore, it mandated that the IRS only make TPCs in situations where it is unable to obtain data directly from the taxpayer. The legislative history states the following on this topic:

> The [Senate Finance] Committee believes that taxpayers should be notified before the IRS contacts third parties regarding examination and collection activities with respect to the taxpayer. Such contacts may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community. Accordingly, the [Senate Finance] Committee believes that taxpayers should have the opportunity to resolve issues and volunteer information before the IRS contacts third parties.[35]

Second, in issuing the regulations implementing Section 7602, the IRS recognized that premature TPCs could unnecessarily damage taxpayers, such that taxpayers should have the right to first satisfy all requests. Preamble to the regulations explains the following:

> [T]he final regulations balance a taxpayer's business and reputational interests with third parties' privacy interests and the IRS' responsibility to administer the internal revenue laws effectively. By providing general pre-contact notice followed by post-contact identification, these final regulations enable a taxpayer to come forward with information required by the IRS before third parties are contacted. The taxpayer's business and reputational interests therefore can be addressed without impeding the IRS's ability to make those [TPCs] that are necessary to administer the internal revenue laws.[36]

Third, the Internal Revenue Manual confirms some earlier congressional apprehensions. It emphasizes multiple times that the IRS should not utilize TPCs as a primary auditing tool, but rather it should first grant the taxpayer under audit a chance to supply the data. The Internal Revenue Manual makes this clear in several places:

> The intent behind [Section 7602] is to prevent the [IRS] from disclosing to third parties that the taxpayer is the subject of [an IRS] action without first providing reasonable notice to the taxpayer and allowing the taxpayer an opportunity to provide the information and resolve the matter.[37]

> [Revenue Agents are directed] to give notice to taxpayers, allowing them an opportunity to provide the information, before disclosing to a third party that the taxpayer is the subject of an [IRS] action.[38]

> The intent behind this statute is to provide the taxpayer, in most cases, with the opportunity to produce the information and documents requested before the IRS must obtain the information from third parties.[39]

Fourth, various courts have refused to enforce a summons from the IRS on the grounds that the IRS failed to make adequate efforts to first obtain the relevant data from the taxpayer directly. One recent example is ***J.B. and P.B. v. United States.***[40] In that case, the IRS began an audit, as part of

[32] Memorandum for Associate Area Counsel (SB/SE), Area 4, Louisville, IRC § 200109047

[33] IRM § 4.11.57.6.3 (01-17-2014).

[34] IRC Section 7602(c)(1), as enacted by Public Law 105-206, Internal Revenue Service Restructuring and Reform Act of 1998 (July 22, 1998), Section 3417. IRC Section 7602(c)(1) was later modified by the Taxpayer First Act, Public Law 116-25 (July 1, 2019). The revised version requires the IRS to provide more specific advance notice to the taxpayers about TPCs.

[35] U.S. Senate, Committee on Finance, Internal Revenue Service Restructuring and Reform Act of 1998. 105th Congress, 2nd Session, Report 105-174 (April 22, 1998), pg. 77.

[36] Preamble, Treasury Decision 9028 (Dec. 17, 2002).

[37] IRM § 4.11.57.2 (01-17-2014).

[38] IRM § 4.11.57.1 (5-26-2017).

[39] IRM § 4.11.57.2 (5-26-2017).

[40] *J.B. and P.B. v. United States*, 123 AFTR 2d 2019-859 (Feb. 26, 2019); *See also United States v. Vaught et al*, 128 AFTR 2d 2021-XXXX (Aug. 16, 2021); *See also* Emily L. Foster, IRS's Notice of Third-Party Summonses Doesn't Pass Muster, 2021 Tax Notes Today Federal 159-1 (Aug. 16, 2021).

which it issued a summons to the California Supreme Court seeking employment-related documents. One of the taxpayers was an attorney who accepted appointments to represent indigent defendants in criminal cases so the IRS wanted copies of billing statements, invoices, and other documents about compensation. The taxpayers filed a so-called motion to quash the summons with the District Court.

The District Court evaluated the motion to quash under the standards established by the Supreme Court in *Powell v. United States*.[41] According to that famous case, courts will not uphold a summons, unless the IRS establishes a prima facie case where: the underlying investigation is for a legitimate purpose; the information requested is relevant to that purpose; the information sought is not already in the IRS's possession, custody, or control; and the IRS followed all administrative requirements.[42] The District Court in *J.B. and P.B. v. United States* held that the IRS failed this final requirement because it violated Section 7602.

**As noted by Congress, in light of the "chilling effect on business," "reputational damage," and other negative consequences of the IRS meddling in the affairs of partners, one would guess that the partnerships, through their TMPs, would make substantial efforts to gather and provide the IRS all available data.**

The Department of Justice ("DOJ") disliked the unfavorable ruling by the District Court, so it elevated the dispute to the Court of Appeals for the 9th Circuit. It affirmed the earlier decision by the District Court, expansively interpreting Section 7602 in favor of taxpayers in various ways. For example, the 9th Circuit set the following high standard of what "reasonable notice in advance" means:

> [N]otice reasonably calculated, under all the relevant circumstances, to apprise interested parties of the possibility that the IRS may contact third parties, and that affords interested parties a meaningful opportunity to resolve issues and voluntary information before [TPCs] are made [by the IRS].[43]

The 9th Circuit further explained that the entirety of Section 7602 indicates that the IRS must offer taxpayers a meaningful chance to supply all requested data personally before it resorts to bugging others for it:

> A reasonable notice must provide the taxpayer with a meaningful opportunity to volunteer records on his own, so that [TPCs] may be avoided if the taxpayer complies with the IRS's demand.[44]

Finally, the 9th Circuit established the following standard for the IRS:

> Drawing on our case law in this area, we conclude that the IRS does ***not*** satisfy the pre-contact notice requirement . . . unless it provides notice reasonably calculated, under all relevant circumstances, to apprise interested parties of the possibility that the IRS may contact third parties, and that affords interested parties a meaningful opportunity to resolve issues and volunteer information before those [TPCs] are made.[45]

What is the effect of the preceding? The short answer is that it undermines any attempt by the IRS to circumvent the rules by labeling partners as third parties and approaching them directly during an audit. As explained earlier, by the IRS's own admission, partners are considered part of the partnership for tax dispute purposes. Even if they were not, the previously described sources are unified in indicating that the IRS must first seek all data from the partnership (through the TMP and tax defense counsel) before involving the partners. Indeed, they state that the IRS must give the partnership a "meaningful opportunity to resolve issues and volunteer information" before the IRS is allowed to contact individual partners. As noted by Congress, in light of the "chilling effect on business," "reputational damage," and other negative consequences of the IRS meddling in the affairs of partners, one would guess that the partnerships, through their TMPs, would make substantial efforts to gather and provide the IRS all available data.

## Problem 3: Seeking data from partners during an administrative appeal

Appeals officers historically could make TPCs in connection with an administrative hearing with taxpayers.[46] Such TPCs could have been made with partners of the partnerships.[47] However, matters radically changed in January 2022. The IRS issued a memo to all employees of the Appeals office stating that, effective immediately, TPCs were "prohibited and should no longer be made."[48] Why the sudden change of heart? The memo explained that "[b]ecause Appeals employees are required to take a quasi-judicial approach in the way they handle cases, they are prohibited from performing investigative actions," including making TPCs.[49]

## Problem 4: Seeking data from partners in preparation for trial

Along with approaching indirect individual partners during audits and administrative appeals, the IRS often attempts to solicit data from them in preparation for Tax Court litigation. This creates a fourth problem for the IRS.

**Initial cooperation required.** A taxpayer often challenges an unfavorable final notice in Tax Court. After the taxpayer and the IRS attorneys have submitted all their initial pleadings (i.e., the petition, answer, and reply), they can start the pretrial discovery process. The Tax Court requires 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.[50] Additionally, the parties must stipulate "to the fullest extent to which complete or qualified agreement can or fairly should be reached" all facts and documents that are relevant to the case.[51] The Internal Revenue Manual is unambiguous in directing IRS attorneys to exhaust all informal means before upping the intensity:

> The Tax Court is insistent that 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 will not be tolerated.[52]

**General discovery rules.** The parties enjoy significant latitude in making inquiries; they can seek any data that is not privileged and "is relevant to the subject matter involved in the pending case."[53] The fact that the specific data sought by the parties cannot 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."[54]

The use of discovery tools is not limitless. The Tax Court can control the frequency or extent of data requests if it determines that the data sought is unreasonably cumulative or duplicative, the party seeking the data could obtain it more conveniently from another source, the party seeking the data has already had "ample opportunity" to obtain it, or 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.[55]

**Protective orders.** What remedies do parties or other persons have when the IRS oversteps its bounds in the discovery setting? One possibility is seeking a so-called protective order.[56] The Tax Court Rules state that, in response to a motion "by a party or any other affected person" and for "good cause," the Tax Court can issue any order that justice requires to protect the party or other person from annoyance, embarrassment, oppression, or undue burden or expense.[57]

**Recent protective order for partners.** 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 in the consolidated cases were entitled to charitable deductions of $0.[58] Thus, the remaining issues centered on penalties, including whether the partnerships had any defenses to them.[59] The partnerships alleged that they should escape penalties because they had "reasonable cause" for the tax underpayments, obtained "qualified appraisals," relied on such appraisals, and conducted

41 *Powell v. United States*, 379 U.S. 48 (1964).

42 *Ibid*.

43 *J.B. v. United States*, No. 16-15999 (9th Cir. 2019).

44 *Ibid*.

45 *Op. cit.* note 43.

46 IRM § 8.1.6.2.1 (01-02-2015). The Appeals Office sent Letter 3164-L warning the taxpayer that it "will contact other persons" as part of the administrative review process.

47 IRM § 8.1.6.2 (01-02-2015) (referencing readers to the general rules applicable to the "Third Party Contact Program").

48 IRS Memo, Interim Guidance – Appeals Policy on Third Party Contacts, Control No. AP-02-0122-0001, January 14, 2022; "Appeals Employees Advised of Ban on Third Party Contacts, 2022 Tax Notes Today Federal 15-22 (Jan. 14. 2022).

49 *Ibid*.

50 *Branerton Corp. v. Commissioner*, 61 T.C. 691 (1974).

51 Tax Court Rule 91(a)(1).

52 IRM § 35.4.3.2 (08-11-2004).

53 Tax Court Rule 70(b).

54 *Ibid*.

55 Tax Court Rule 70(c)(1).

56 Tax Court Rule 103.

57 Tax Court Rule 103(a). Among other things, a protective order issued by the Tax Court can require that a particular method or procedure not be used; a method or procedure be used only on specified terms and conditions; a different method or procedure be used; certain matters not be inquired into or limited in scope; a method or procedure be conducted with no one present except persons designated by the Tax Court; a deposition or other written materials, after being sealed, be opened only by Order of the Tax Court; a trade secret or other information not be disclosed or disclosed only in a particular way; (viii) the parties simultaneously file specified documents or information enclosed in sealed envelopes to be opened as directed by the Tax Court; expenses involved in a method or procedure be paid by a specified person or persons; or documents or records be impounded by the Tax Court to ensure their availability for purpose of review by the parties before and during trial.

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

59 *Ibid*.

their own "good faith investigation" of the values of the easements.

To prepare its case on these and other matters, the IRS attorneys contacted indirect individual partners before trial to ask questions and seek information.[60] The partnership filed a motion with the Tax Court seeking a protective order that would stop the IRS attorneys from further contacting indirect individual partners, prohibit them from reviewing any of the data that they had already received from the partners, and obligate them to supply an accounting to the partnership of any data they previously obtained.

The IRS objected on grounds that the partnerships did not demonstrate "good cause" for a protective order, as required by the Tax Court Rules; the data sought and/or obtained from the indirect individual partners was not protected by the attorney-client privilege or any other privilege; the requests by the partnership would unnecessarily restrict the informal pretrial discovery process; and the actions by the IRS were appropriate because they did not circumvent the discovery rules and the data sought from the partners was relevant to the case.

**Few have made the connection, but the behavior by the IRS in the Tax Court case focused on the previously mentioned conservation easement donations, Green Valley Investors, is nearly identical to that by the Department of Justice (DOJ) in a District Court case seeking to enjoin certain parties from involvement in such donations.**

In what partnerships surely will label a significant victory, the Tax Court disagreed with the IRS. The Court stated that sending informal discovery requests to the indirect individual partners of the PropCos "thwarts the spirit of informal discovery between the parties" and emphasized that such partners "are not unrelated third parties." The Tax Court then mandated that the IRS send such requests to the TMP of the partnerships rather than to their partners.

The Tax Court cited the model rules of the American Bar Association in support of its decision. It specifically referenced Model Rule 4.2, the comments to which explain that it is designed to prohibit communications by a party in litigation with "a constituent of the organization who supervises, directs, or regularly consults with the organization's lawyer concerning the matter . . . or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability."[61] The Tax Court then explained that partners who receive allocations of charitable tax deductions from easement donations through their indirect ownership in the PropCos should be considered "constituents" of the PropCos in this context. The Tax Court thus concluded that "direct contact of the [indirect] individual partners by [the IRS attorneys] does not appear to be appropriate under Model Rule 4.2." Accordingly, the Tax Court granted the protective orders sought by the partnerships.

**Similar governmental actions in injunction suit.** Few have made the connection, but the behavior by the IRS in *Green Valley Investors* is nearly identical to that by the DOJ in a District Court case seeking to enjoin certain parties from involvement in such donations.

In *United States v. Nancy Zak et al.*, the DOJ claimed that the case centers on statements that the defendants supposedly made to potential investors about investment opportunities. For purposes of gathering data on this issue, the DOJ attorneys sent letters to a significant number of indirect individual partners titled "request for interview and for documents." The letters referenced the ongoing injunction lawsuit, indicated that the partners participated in at least one of the relevant transactions, asked for an interview, sought a long list of materials, and instructed the partners to contact certain DOJ attorneys as soon as possible.

The defendants immediately raised the issue with the District Court, explaining that they had already provided about 150,000 documents to the DOJ and had agreed to submit many more within a month, while the DOJ itself had previously collected over 1.6 million pages from various sources including partners. The defendants also emphasized that the DOJ, just one day after the District Court had ordered it to refrain from issuing third-party

[60] *Op. cit.* note 58; See also Parillo, K. A., Court bars IRS discovery of individual partners in easement case, *Tax Notes Federal Today* 8-4 (Jan. 12, 2022).

[61] American Bar Association Model Rule 4.2, *Communication with Person Represented by Counsel*.

[62] *United States v. Nancy Zak et al*, N.D. Georgia, Case No. 1:18-cv-05774-AT, The Ecovest Parties' Reply to the United States' Reponse to Order Regarding Subpoenas, January 15, 2020.

[63] Parillo, K. A., DOJ ordered to amend letters to investors in easement case, *Tax Notes Federal* (Feb. 3, 2020): 818. See also Civil Docket for Case No. 1:18-cv-05774-AT, Order by Docket Entry Only, January 17, 2020.

[64] *Ibid.*

subpoenas until further notice, sent the "official-looking form letters" to an unknown number of indirect individual partners.[62]

The District Court, siding with the defendants, corrected a previous order to ensure that the DOJ re-sent the letters to indirect individual partners, this time clarifying that they are not legally required to participate in an interview with, or provide materials to, the DOJ. Specifically, the District Court forced the DOJ to issue a "corrected letter," labeled as such in bold capital letters, inserting the following disclaimer at the end:

> This letter is a request and not a subpoena. You are under no mandatory legal obligation to respond to this letter. However, I would be most interested in interviewing you and reviewing the documents requested . . . If you are represented by counsel, please forward this letter to your attorney, and do not contact [the DOJ attorneys] directly.[63]

The District Court took these steps because of "significant concerns" over the "potentially coercive and misleading nature of the language" in the initial letters sent by the DOJ.[64]

## Conclusion

The IRS has been more assertive in recent years when it comes to gathering data in the context of conservation easement donations and elsewhere. This aggression has manifested itself in several forms, perhaps most notably in the IRS directly approaching individual partners during the audit, administrative appeal, and the prelitigation phases of a partnership dispute. As this article indicates, such behavior creates four major problems for the IRS, and both the Tax Court and District Court have recently issued orders preventing government attorneys from overstepping their bounds with partners. TMPs and individual partners need to be aware of this evolving issue, such that they can assert their rights if the IRS continues with its current practices, despite recent setbacks. ■