Partnerships, "Qualified Offers," and Conservation Easement Disputes: Analyzing Problems with the IRS's Positions, Now and Later

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Hale E. Sheppard continues his series on one of the hottest audit areas this year and exmines making "qualified offers" in conservation easement disputes.

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I. Introduction

Taxpayers embroiled in a tax dispute often feel bullied by the IRS. This is particularly true with partnerships that donated conservation easements to charitable organizations, because the IRS has implemented a long list of aggressive enforcement tactics. The good news is that various mechanisms are available to taxpayers to turn the proverbial tide, one of which is submitting a "qualified offer" to the IRS. In simplified terms, if the IRS ignores or rejects a qualified offer, the case goes to trial, and the court rules that the taxpayer's liability is less than the amount in the earlier qualified offer, then the IRS must reimburse the taxpayer's reasonable administrative and/or litigation costs.

Only two cases have addressed whether partnerships subject to the special proceedings created by the Tax Equity and Fiscal Responsibility Act ("TEFRA") are able to make a qualified offer. Just one of these cases yielded a decision with precedential value, and it explained that TEFRA partnerships are entitled to file qualified offers. Nevertheless, the IRS seems entrenched in its traditional position, arguing as recently as September 2020, in a pending Tax Court case, that TEFRA partnerships are ineligible to file qualified overs, period.

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This article describes the rules related to qualified offers, the two cases addressing the TEFRA partnerships issue, the current stance of the IRS, and the likely result of this standoff, now and in the future.[1]

II. Recouping Costs as a Prevailing Party

Generally, Code Sec. 7430 provides that the "prevailing party" in any administrative proceeding before the IRS, or in any litigation that is brought by or against the government in connection with the determination, collection, or refund of any tax, penalty, or interest may be awarded reasonable administrative and/or litigation costs.[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]

The term "prevailing party" generally means a party in any tax-related administrative proceeding or litigation that (i) has substantially prevailed with respect to either the amount in controversy or the most significant issues presented, and (ii) has a net worth that does not exceed the statutory thresholds.[5] Even if a taxpayer substantially prevails and meets the net worth requirement, he still cannot recover costs from the government, unless other hurdles are overcome. A taxpayer, for example, must exhaust all administrative remedies available within the IRS, but cannot "unreasonably protract" the proceedings.[6]

The taxpayer will not be deemed the "prevailing party" if the government establishes that its position was "substantially justified."[7] In other words, if the government manages to prove that the position it took during the administrative dispute or litigation was substantially justified, then the taxpayer is precluded from recovering costs. There is a rebuttable presumption that the government's position is *not* substantially justified, if it failed to follow its own "applicable published guidance" during a proceeding.[8] Such guidance includes regulations (final or temporary), revenue rulings, information releases, notices, and announcements.[9] It also encompasses items issued to the particular taxpayer involved in a dispute, such as private letter rulings, technical advice memoranda, and determination letters.[10]

Caselaw is helpful in identifying whether the IRS was "substantially justified" in its actions. Certain courts have developed a framework, a non-exhaustive list of factors to consider. Among these are (i) the stage at which the issue or litigation is resolved, (ii) the opinions of other courts on the same 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.[11] Other courts utilize a different approach, scrutinizing whether the position taken by the IRS was reasonable.[12] 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."[13] Still other courts rely on a different test, presenting the question as whether the government knew or should have known that its position was invalid at the time it took it.[14]

III. Recouping Costs Thanks to a Qualified Offer

There is a lesser known, but often more effective, way of obligating the government to pay: making a so-called "qualified offer." A taxpayer is treated as the "prevailing party" if the taxpayer's liability, as ultimately determined in a court judgment, is the same as or less than the liability would have been if the government had accepted the qualified offer.[15]

A. Criteria for Qualified Offers

Generally, a qualified offer is a (i) written offer, (ii) made by the taxpayer, (iii) to the government, (iv) during the "qualified offer period," (v) which specifies the amount offered (excluding interest, unless interest is a contested issue), by stating either a precise dollar amount or a percentage of the proposed adjustments at issue, (vi) is properly designated as a qualified offer at the time the taxpayer makes it, and (vii) remains open for acceptance by the government during the period that begins on the date it is made, and ends on the date that the government rejects the offer, the date that the trial starts, or 90 days after the taxpayer makes the offer, whichever is earliest.[16]

Certain requirements are more lax when it comes to the qualified offer rule:

> [A] taxpayer qualifying as a prevailing party by reason of having made a qualified offer *need not* substantially prevail on either the amount in controversy or the most significant issue or set of issues presented. Similarly, whether the positions of the [government] in the administrative and litigation proceedings were substantially justified *is not relevant* for an award under the qualified offer rule.[17]

B. Main Exceptions

Caveats exist, of course. The qualified offer rule does not apply, for instance, to a proceeding in which the amount of the tax liability is not an issue, such as court actions to obtain a Declaratory Judgment, enforce or quash a Summons, *etc*.[18]

The qualified offer rule is also inapplicable where the parties settle the case *before* a court issues its judgment: "A taxpayer cannot qualify as a prevailing party by reason of having made a qualified offer if the determination of the court in the proceeding with respect to the adjustments included in the last qualified offer is entered exclusively pursuant to a settlement."[19] Stated differently, taxpayers can only recoup fees from the government if they make a "qualified offer," the government ignores or rejects such offer, and the case is resolved through litigation, with the court issuing a decision in favor of the taxpayer. Thus, making a "qualified offer" might convince the IRS to reevaluate the strength of its position and agree to a pre-trial settlement. In such circumstances, the taxpayer would enjoy a lower tax liability, but not fee recoupment, too.[20]

C. Multiple Qualified Offers

If a taxpayer makes more than one "qualified offer" during the dispute-resolution process, then the analysis is based on the "last qualified offer," and the bills do not start accumulating against the government until after the date of the "last qualified offer."[21]

D. Submitting to the Proper Person

The concept of the government is broad, but the regulations refine it somewhat. They state that a qualified offer ordinarily is made to the government when it is delivered to the office or personnel within the IRS, Appeals Office, Office of Chief Counsel, or Department of Justice that or who has jurisdiction over the tax matters at issue in the administrative proceeding or litigation.[22] The regulations contemplate alternative places to deliver a qualified offer, if the taxpayer is unaware of the government office or personnel with jurisdiction over the dispute.[23]

E. Relevant Period

The "qualified offer period" (i) starts the date on which the "first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review" with the IRS Appeals Office is sent, and (ii) ends 30 days before the date on which the case is first set for trial.[24] The Preamble to the proposed regulations elucidates the "qualified offer period."

> The qualified offer period ends on the date which is thirty days before the date the case is first set for trial. In cases that are pending in the United States Tax Court, cases are placed upon a calendar for trial. Each case appearing on a trial calendar is to be called at the time and place scheduled. In determining when the qualified offer period ends for cases in the Tax Court and other courts of the United States using calendars for trial, a case is considered to be set for trial on the date scheduled for the calendar call. Cases may be removed from a trial calendar at any time. Thus, a case may be removed from a calendar before the date that precedes by thirty days the date scheduled for that calendar. To promote the settlement of such cases, the qualified offer period does not end until the case remains on a calendar for trial on the date that precedes by 30 days the scheduled date of the calendar call for that trial session.[25]

F. Minimum Amount

The qualified offer rules do not demand a minimum amount, do not define the size of a reasonable offer, and do not mandate that an offer be for a certain percentage of the proposed liability. Consequently, when taxpayers are confident that they ultimately will convince a court that their liability is $0 or they are due a refund, taxpayers can make a "qualified offer" consisting of merely $1 and still recoup fees from the government.[26]

IV. Partnerships and Qualified Offers

Cases involving whether a taxpayer is entitled to fee recoupment under Code Sec. 7430 abound, but those focused on whether TEFRA partnerships can benefit from the qualified offer rule are scarce. Indeed, just two cases, both recent, have addressed this important issue. These cases are examined below.[27]

A. First Case—BASR Partnership[28]

This case surely left a bad taste in the government's mouth. First, the IRS squandered its chance to challenge a partnership that engaged in a Son-of-BOSS transaction because it issued the notice of final partnership administrative adjustment ("FPAA") too late. Second, as discussed

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below, the partnership made the government pay for its stubborn litigiousness, collecting administrative and legal fees after the fact.

1. Partnership Victory and Claim for Fees

The partnership engaged in a Son-of-BOSS transaction in 1999, the IRS ultimately issued an FPAA, the partnership filed a Complaint in the Court of Federal Claims ("COFC"), arguing that the IRS could not pursue the partnership because it issued the FPAA after the assessment-period had expired, and the COFC ruled in favor of the partnership.[29]

This stance by the IRS likely will lead to many TEFRA partnerships filing qualified offers at the start of the "qualified offer period," when the partnerships have a significant informational advantage over the IRS as to the true value of the easements.

Later, the partnership filed a motion for litigation costs with the COFC under Code Sec. 7430, arguing that it made a qualified offer of $1, the government rejected the offer, and the partnership ultimately won, with the COFC determining that the liability was $0.

2. Main Arguments by the DOJ

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

Second, the DOJ maintained that the qualified offer was not made during the "qualified offer period." Code Sec. 7430(g)(2) says that this period starts "the date on which the [first] letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent." The DOJ pointed out that no "letter of proposed deficiency" was sent to the partnership, so the "qualified offer period" never started, which means that the partnership could not possibly have made a qualified offer during the "qualified offer period." The DOJ further argued that an FPAA does not give a partnership an opportunity for review by the Appeals Office because it is considered a "final" administrative determination, as denoted right in the name. Finally, the DOJ explained that the FPAA is not a "letter of proposed deficiency" because it does not identify the tax, penalties, or interest due.

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

3. Reasoning by the COFC

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

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

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

> (3) Others. (i) *A taxpayer that is a partnership*, corporation, association, unit of local government, or organization … meets the net worth and size limitations of this paragraph if, as of the administrative proceeding date: (A) The taxpayer's net worth does not exceed

seven million dollars; and (B) The taxpayer does not have more than 500 employees.[30]

(5) *Special rule for TEFRA partnership proceedings*. (i) *In cases involving partnerships* subject to the unified audit and litigation procedures of subchapter C of chapter 63 of the Internal Revenue Code (TEFRA partnership cases), *the TEFRA partnership* meets the net worth and size limitations requirements of this paragraph (g) if, on the administrative proceeding date: (A) *The partnership's* net worth does not exceed seven million dollars; and (B) *The partnership* does not have more than 500 employees.[31]

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

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

The COFC rejected the DOJ's position on the following grounds:

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

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

c. The Offer was Made During the "Qualified Offer Period". As explained above, the "qualified offer period" starts "the date on which the [first] letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent."[32]

The DOJ argued that the IRS only issued an FPAA to the partnership, an FPAA does not constitute a "letter of proposed deficiency," so the "qualified offer period" never started, and the offer that the partnership made could not have occurred during the "qualified offer period."

The COFC discarded this argument for several reasons, the most relevant of which are explained here. First, the regulations under Code Sec. 7430 specifically state that an FPAA will be treated as a Notice of Deficiency in this context: "For purposes of determining reasonable administrative costs under Code Sec. 7430 and the regulations thereunder, the following will be treated as a notice of deficiency … notice of [FPAA] described in Code Sec. 6223(a)(2)."[33] Second, both the Court of Appeals for the Fifth Circuit and the Tax Court have issued opinions in the past ruling that an FPAA is the functional equivalent of a Notice of Deficiency.[34] Third, one of the examples provided by the IRS in its own regulations expressly indicates that taxpayers still get the benefit of the qualified offer rule, even though the IRS issues the taxpayer a Notice of Deficiency without first sending an Examination Report with proposed adjustments.[35]

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

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

[Code Sec. 7430] does not require any minimum amount or define the parameters of a "reasonable" offer, nor does it require that an offer be for a certain

> percentage of the taxpayer's purported tax liability …. Indeed, the Government has offered no amount that [the partnership] could have offered that would have been "reasonable." In this case, the final judgment of the court not to sustain the FPAA on the basis that the FPAA was untimely issued resulted in $0 tax liability for [the] partners. Because $1 is more than $0, the court has determined that [the partnership's] "qualified offer" complied with [Code Sec. 7430].

B. Second Case—Hurford Investments No. 2, Ltd.[36]

The Tax Court held in favor of the taxpayer on its Motion for Summary Judgment in this TEFRA partnership proceeding.[37] Then, in a quest for full vindication, the taxpayer filed a motion seeking reasonable administrative and litigation costs. As the Tax Court put it, "Petitioner won [and] now petitioner wants respondent to pay the cost of his victory."[38]

1. Positions of the Parties

The partnership sought nearly $500,000 in expenses on two alternative theories. The partnership claimed that it was the "prevailing party," but even if it were not, it made a qualified offer to the IRS and obtained a more favorable result through Tax Court litigation.[39]

The IRS countered with several points, including that its position was "substantially justified," such that the partnership was not the "prevailing party," and the offer by the partnership did not constitute a "qualified offer."[40]

2. Reasoning by the Tax Court

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

a. Was the IRS's Position Substantially Justified? The Tax Court explained that it ruled in favor of the IRS because its legal/tax position was consistent during both the administrative and litigation phases of the dispute, there was little caselaw interpreting the pertinent tax provisions, the issues arose because of "extraordinarily strange estate planning" by the taxpayer, the case involved a "very close question" of law, and the issue was novel.[41] In light of these circumstances, the Tax Court concluded that the IRS's position was "substantially justified," meaning that the partnership was not the "prevailing party."[42]

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

> A party to a court proceeding … shall be treated as the prevailing party *if the liability of the taxpayer* pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the *liability of the taxpayer* which would have been so determined if the United States had accepted a qualified offer of the party ….[43]

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

> The term "qualified offer" means a written offer which (A) is made by the taxpayer to the United States during the qualified offer period; (B) specifies the offered amount *of the taxpayer's liability* (determined without regard to interest); (C) is designated at the time it is made as a qualified offer for purposes of this section; and (D) remains open during the period beginning on the date it is made and ending on the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made.[44]

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

> A qualified offer specifies the offered amount if it clearly specifies the amount for the liability of the taxpayer …. The offer may be a specific dollar amount of the total liability or a percentage *of the adjustments at issue in the proceeding* at the time the offer is made. This amount must be with respect *to all of the adjustments at issue in the administrative or court proceeding* at the time the offer is made and only those adjustments. The specified amount must be an amount, the acceptance of which by the United States *will fully resolve the taxpayer's liability, and only that liability* … for the type or types of tax and the taxable year or years at issue in the proceeding ….[45]

The threshold question, according to the Tax Court, is whether a TEFRA partnership can even make a qualified offer in the first place. This is critical, because the qualified

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offer rule does not apply to "any proceeding in which the amount of tax liability is not in issue."[46] The Tax Court indicated that the fundamental issue was "whether a TEFRA case is one in which the amount of tax liability is not in issue."[47]

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

> It might not, of course, be immediately obvious to a nonspecialist how [the Tax Court's] power to redetermine a deficiency is one in which tax "liability" is at issue. But that connection is a matter of chasing cross-references in the Code. "Liability" for a tax or penalty is an amount fixed by the Code sections that impose a tax or penalty. A "deficiency" is the amount by which a taxpayer's true liability under the Code exceeds the tax liability that he reported on his return. So when our Court redetermines a deficiency it must also determine a taxpayer's liability under the Code. *This does not seem to be true of TEFRA cases, which means the Code's definition of a 'qualified offer' doesn't seem to fit. The chief reason is that the result of a TEFRA case is not the determination of any taxpayer's liability*.[48]
>
> The regulatory definition of a 'qualified offer' that we quoted above does speak of 'adjustments at issue in the proceeding.' Viewed in isolation that would suggest that it is possible to make a qualified offer in a TEFRA case. *But in this TEFRA case —like most— no particular taxpayer's liability is in issue, and the name petitioner (typically a partnership) doesn't even have a tax liability under the Code, even though its partners may. We conclude from this that a partnership like [Hurford] is not even a 'taxpayer.'*[49]

To its credit, the Tax Court recognized that the COFC came to the exact opposite conclusion regarding whether a TEFRA partnership can make a qualified in *BASR Partnership*. However, the Tax Court explained that it "respectfully disagreed" with the COFC because, from its perspective, a TEFRA partnership proceeding determines only partnership items, while the liability of individual partners depends on subsequent computational adjustments and, potentially, deficiency proceedings at the individual level.[50]

3. Precedential Value of Tax Court Orders

Importantly, the Tax Court issued its decision in *Hurford Investments No. 2 Ltd.* via an "Order," and Tax Court Rule 50(f) explicitly states that "Orders shall *not* be treated as precedent, except as may be relevant for purposes of establishing the law of the case, res judicata, collateral estoppel, or other similar doctrine."

C. Appellate Review of First Case—BASR Partnership

The DOJ filed an appeal with the Court of Appeals for the Federal Circuit of the earlier decision by the COFC. The DOJ raised five challenges, two of which are relevant to this article. Notably, the DOJ sent a letter to the Court of Appeals several weeks before it published its opinion, drawing attention to the decision by the Tax Court in *Hurford Investments No. 2, Ltd.* and claiming that it directly supports the DOJ's position.[51] The Court of Appeals does not mention the letter or the reasoning by the Tax Court in rendering its opinion.[52]

1. Was the Partnership a "Party"?

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

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

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

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

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a partnership can receive litigation costs in a TEFRA judicial proceeding.

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

> For the purposes of this subsection … "party" means (i) an individual whose net worth did not exceed $2,000,000 at the time the civil action was filed, or (ii) any owner of an unincorporated business, *or any partnership*, corporation, association, unit of local government, or organization, the net worth of which did not exceed $7,000,000 at the time the civil action was filed, and which had not more than 500 employees at the time the civil action was filed ….[53]

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

2. Was a Tax Liability "In Issue"?

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

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

D. Reconsideration of Second Case—Hurford Investments No. 2, Ltd.

In March 2019, soon after the Federal Circuit Court of Appeals issued the taxpayer-favorable decision in *BASR Partnership*, the partnership in *Hurford Investments No. 2, Ltd*. filed a Motion for Reconsideration with the Tax Court. In short, the partnership asked the Tax Court if it really wanted to disagree with a court perched above it on the judicial hierarchy.[54]

1. Decisions by the Tax Court

The Tax Court began with an issue that would not place it in conflict with the Federal Circuit Court of Appeals; that is, even if TEFRA partnerships generally can make qualified offers, was the precise one presented by the partnership in *Hurford Investments No. 2, Ltd*. satisfactory? No, explained the Tax Court, because it was not limited to the proposed adjustment in the FPAA, trying instead to settle the effect of the partnership-level proceeding on all the individual partners.[55]

Next, the Tax Court centered on the broader issue of whether TEFRA partnerships are capable of filing a qualified offer at all. It described certain "problems" with the legal analysis by the Federal Circuit Court of Appeals, which were primarily focused on the proper meaning of the phrases "in issue" and "at issue" in the context of a tax proceeding.[56] The Tax Court then introduced some practical considerations, as follows, in maintaining what it calls a "respectful disagreement" with the Federal Circuit Court of Appeals:

> The qualified offer rules are also, in the run-of-the-mill deficiency cases, easy to administer even by almost innumerate judges—he has only to compare two numbers and ask which is the larger. But it would not be administrable in the typical [TEFRA] partnership-level case where there might be a sea of partner-specific numbers for him to wade through them all before he reached the shore of simple comparison.[57]

2. Precedential Value of Tax Court Orders

The Tax Court, consistent with its original decision, responded to the partnership's Motion for Reconsideration by way of an "Order," not a Tax Court Opinion, or even a Tax Court Memorandum. As explained above, Tax Court Rule 50(f) generally explains that "Orders shall *not* be treated as precedent."

V. TEFRA Partnerships and Conservation Easement Donations

In many cases involving conservation easement donations, the partnership has conducted extensive due

diligence before donating in order to determine the conservation purposes, highest and best ("HBU") for the property, value of the easement, compliance with all laws and regulations, *etc*. This due diligence often entails obtaining title opinion letters, market analyses, business plans, cost estimates, zoning approvals, permits, environmental reports, wetland studies, photographs, legal and/or tax opinions, appraisals (original, secondary, and desk review), and more. Despite this tangible work by the partnership, and despite the fact that the IRS rarely hires independent appraisers, engineers, environmentalists, or other professionals to analyze the property during an audit, most FPAAs nowadays limit themselves to the following description:

> It has not been established that all the requirements of I.R.C Section 170 have been satisfied for the non-cash charitable contribution of a qualified conservation contribution. Accordingly, the charitable contribution deduction is decreased by [the entire amount claimed on the Form 1065].
>
> Alternatively, if it is determined that all the requirements of I.R.C Section 170 have been satisfied for all or any portion of the claimed non-cash charitable contribution, it has not been established that the value of the contributed property interest was greater than zero.[58]

After claiming that the charitable donation deductions should be $0, the IRS then proposes several alternative penalties in an FPAA, ranging in severity. These often include penalties for negligence, substantial understatement of income tax, substantial valuation misstatement, gross valuation misstatement, or reportable transaction understatement.[59]

This IRS's tactic is problematic (and some might say heavy-handed or worse) because (i) there is a legal presumption that the FPAA is correct, (ii) taxpayers normally cannot "go behind the FPAA" and present evidence to the Tax Court related to the audit, such as the responses to Information Documents Requests, Examination Reports, Summary Reports, or Notices of Proposed Adjustments, and (iii) taxpayers ordinarily have the burden of proof during a Tax Court trial, meaning that they must present sufficient evidence to overcome the presumed correctness of the FPAA.[60] Thus, the reality is that, unless the IRS later identifies the specific issues that it is truly challenging (*e.g.*, via responses to discovery requests, Stipulations of Fact, Stipulations of Settled Issues, or Pre-Trial Memoranda), the taxpayer might be obligated to prove at trial that it satisfied *every single requirement* on an extremely long list in order to secure its charitable deduction under Code Sec. 170.[61] The magnitude of this endeavor for taxpayers is illustrated by the ATG, which contains a chart spanning four pages called the "Conservation Easement Issue Identification Worksheet."[62]

VI. Entrenchment by the IRS

Because the IRS habitually issues FPAAs to partnerships fully disallowing charitable tax deductions stemming from conservation easements, and because the IRS refuses to reveal the factual, legal or tax grounds for doing so in the FPAAs, some partnerships have started taking the IRS to task by filing qualified offers.

In one pending case, the partnership offered to settle based on the value of the conservation easement, as determined by the IRS's own appraiser during the audit, and as asserted by the IRS as one of its positions in the FPAA. The IRS's appraiser had accepted 84 percent of the value originally claimed by the partnership on its relevant Form 1065. Nevertheless, citing to a supposed technical flaw in the Deed of Conservation Easement, the IRS later issued an FPAA fully disallowing the easement-related deduction. In other words, in its FPAA, the IRS accepted 0 percent of the original value, not the 84 percent accepted by its own appraiser just months earlier.[63]

The partnership, recognizing the risks and costs associated with any Tax Court litigation regardless of how strong a case might be, proposed to conclude matters using the figures calculated by the IRS's appraiser. The partnership sent a qualified offer to the IRS. Did the IRS accept the offer, such that the IRS could immediately collect millions in tax revenue and interest, avoid spending significant taxpayer dollars in Tax Court litigation, reallocate its limited resources to other enforcement activities, and publicly hail this as an IRS victory? No. Did the IRS outright reject the offer, as a confident party would do, thereby drawing a clear line in the sand as to when the fee-recoupment-clock started ticking? No.

Instead, without even mentioning *BASR Partnership* and its taxpayer-favorable decisions in the COFC and the Federal Circuit Court of Appeals, and without acknowledging that the Orders favoring the IRS in *Hurford Investments No. 2 Ltd*. have no precedential value, the IRS claimed that settlement proposal by the partnership, which accepted the valuation by the IRS's own appraiser, did not constitute a "qualified offer." Below was the IRS's reasoning:

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In a TEFRA partnership proceeding, the tax treatment of a partnership item is determined at the partnership level. A reviewing court is not determining "the amount of the tax liability" (or a deficiency) of any partner, as would be necessary for the qualified offer rule to apply. After the TEFRA partnership proceeding concludes and become finale, the tax liability of the partners can be determined at the partner level. It is in the partner-level proceedings (administrative and/or judicial) that the amount of a partner's tax liability is determined and in issue. Accordingly, a partnership cannot make a qualified offer in a partnership level proceeding under TEFRA because the qualified offer rule requires the judgment of the court to address the "liability of the taxpayer." The partnership is not a taxpayer, rather tax liabilities flow through to the partners, but the partners' liabilities are not at issue in the TEFRA proceeding.[64]

VII. Conclusion

The U.S. government has employed many aggressive tactics in attacking partnerships that make easement donations to charitable organizations, including, but certainly not limited to, (i) identifying them as "listed transactions" in Notice 2017-10, thereby mandating the filing of Form 8886 (Reportable Transaction Disclosure Statement) and Form 8918 (Material Advisor Disclosure Statement) by various parties, (ii) launching a "compliance campaign," devoting dozens of IRS personnel to the cause, (iii) filing a Complaint in District Court seeking an injunction on activities by certain appraisers and organizers, (iv) including easements on the IRS's "dirty dozen" list, (v) launching a congressional inquiry into potential abuses, (vi) announcing that it intends to pursue promoters, appraisers, return preparers, material advisors, accommodating entities, charitable organizations, and others, (vii) eliminating a longstanding multi-level review process designed to ensure that appraisers have engaged in a high degree of wrongdoing before asserting penalties, (viii) appointing a new "Promoter Investigations Coordinator," (ix) forming a new "Fraud Enforcement Office," (x) issuing written guidance about depriving partnerships of their general right to seek review by the Appeals Office "where sound tax administration is best served," and (xi) engaging in a widespread practice of issuing FPAAs claiming that charitable contribution donations should be worth $0.[65]

Apparently, the IRS has now added to the list taking the broad position that TEFRA partnerships are unable to make qualified offers, despite the fact that the COFC and Federal Circuit Court of Appeals have rejected this position in *BASR Partnership*, and despite the fact that the contrary decision by the Tax Court in *Hurford Investments No. 2 Ltd.* was issued a non-precedential "Order." This stance by the IRS likely will lead to many TEFRA partnerships filing qualified offers at the start of the "qualified offer period," when the partnerships have a significant informational advantage over the IRS as to the true value of the easements. Then, after participating in a Tax Court trial and obtaining a ruling that the value is as little as $1 more than the amount previously offered, the partnerships, relying on *BASR Partnership*, likely will file actions or motions for recoupment of administrative and litigation fees.

The IRS's position about supposed limitations on qualified offers appears short-lived in all events. The new partnership procedures enacted by the Bipartisan Budget Act ("BBA") apply to 2018 and future years, and the IRS has already begun audits of easement donations in 2018. Under the general BBA rules, any adjustments to partnership-related items are made at the partnership level, and any corresponding taxes, penalties, additions, *etc.* are assessed and collected at the partnership level, not at the partner level.[66] These new rules seemingly undermine the IRS's ability to argue, when it comes to 2018 and later, that the partnership is not a party to the dispute or that its tax liability is not at issue.

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ENDNOTES

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1 This article supplements an earlier article on the same topic. *See* Hale E. Sheppard, *Making Qualified Offers in Partnership Disputes: Extreme Positions by the IRS in Conservation Easement Cases Might Backfire*, JOURNAL OF PASSTHROUGH ENTITIES, 2019.

2 Code Sec. 7430(a).

3 Code Sec. 7430(c)(2).

4 Code Sec. 7430(c)(1).

5 Code Sec. 7430(c)(4)(A). In cases involving partnerships that are subject to the special partnership-level proceedings created by the Tax Equity and Fiscal Responsibility Act ("TEFRA"), a partnership meets the net worth and size limitation standards if, on the day of the administrative proceeding, the partnership's net worth is not more than $7 million, the partnership does not have more than 500 employees, and each partner requesting reimbursement also meets the corresponding net worth and size limitations. *See* Reg. §301.7430-5(g)(5).

6 Code Sec. 7430(b)(1); Code Sec. 7430(b)(3).

7 Code Sec. 7430(c)(4)(B)(i).

8 Code Sec. 7430(c)(4)(B)(ii).

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

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

11 *National Federation of Republican Assemblies*, 263 FSupp2d 1372, 1378 (S.D. Ala. 2003).

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

[13] *Jr. N.R. Wilkes*, CA-11, 2000-1 USTC ¶60,373, 289 F3d 684, 688 (11th Cir. 2002).

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

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

[16] Code Sec. 7430(g)(1); Reg. §301.7340-7(c); Reg. §301.7430-7(c); CC-2010-007 (Apr. 2, 2010) (called "Procedures for Evaluating and Responding to Qualified Offers Submitted Under Section 7430(g)").

[17] T.D. 8922, 2001-1 CB 508, Preamble (emphasis added); *See also* Reg. §301.7430-7(b)(1).

[18] Code Sec. 7430(c)(4)(E)(ii); Reg. §301.7430-7(a).

[19] T.D. 8922, 2001-1 CB 508, Preamble; *See also* Code Sec. 7430(c)(4)(E)(ii); Reg. §301.7430-7(a).

[20] Reg. §301.7430-7(e) Example 8.

[21] Code Sec. 7430(c)(4)(E)(iii).

[22] Reg. §301.7430-7(c)(2)(i).

[23] Reg. §301.7430-7(c)(2)(i).

[24] Code Sec. 7430(g)(2); Reg. §301.7430-7(c)(7).

[25] T.D. 8922, 2001-1 CB 508, Preamble.

[26] *BASR Partnership*, FedCl, 2017-1 USTC ¶50,144, 130 FedCl 286, 119 AFTR 2d 2017-614.

[27] There is one more case that is arguably relevant, though it only commented on the relevant issue, in passing, in identifying which persons had to meet the net worth requirement. *See Foothill Ranch Co. Partnership*, 110 TC 94, Dec. 52,555 (1998) (citing to the Equal Access to Justice Act and stating that the IRS's proposed look-through rule "contradicts the congressional determination that a partnership may receive litigation costs.")

[28] *BASR Partnership*, FedCl, 130 FedCl 286, 2017-1 USTC ¶50,144 (2017), 119 AFTR 2d 2017-614.

[29] *BASR Partnership*, FedCl, 113 FedCl 181 (2013), 2013-2 USTC ¶50,527, 112 AFTR 2d 2013-6313.

[30] Reg. §301.7430-5(g)(3)(i) (emphasis added).

[31] Reg. §301.7430-5(g)(3)(i) (emphasis added).

[32] Code Sec. 7430(g)(2).

[33] Reg. §301.7430-3(c)(3)(i).

[34] *See Sealy Power, Ltd.*, CA-5, 95-1 USTC ¶50,103, 46 F3d 382, 385 (5th Cir. 1995) and *Clovis I*, 88 TC 980, 981, Dec. 43,856 (1987).

[35] Reg. §301.7430-7(e) Example 14.

[36] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, 12/21/18.

[37] *T.G. Hurford Est.*, 96 TCM 422, Dec. 57,610(M), TC Memo 2008-278.

[38] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, 12/21/18, at 4-5.

[39] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, Dec. 21, 2018, at 5.

[40] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, Dec. 21, 2018, at 5.

[41] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, Dec. 21, 2018, at 6.

[42] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, Dec. 21, 2018, at 6.

[43] Code Sec. 7430(c)(4)(A)(i) (emphasis added by Tax Court).

[44] Code Sec. 7430(g)(1)(b) (emphasis added by Tax Court).

[45] Reg. §301.7430-7(c)(3) (emphasis added by Tax Court).

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

[47] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, Dec. 21, 2018, at 8.

[48] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, Dec. 21, 2018, at 8–9.

[49] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, Dec. 21, 2018, at 10.

[50] *Hurford Investments No. 2, Ltd.*, Docket No. 23017-11, Tax Court Order, Dec. 21, 2018, at 12. The Tax Court indicated that, even if partnerships could make qualified offers in a TEFRA proceeding, the specific offer made by the partnership in this case would be not considered a qualified offer because it was not limited to the adjustments in the FPAA, as required by the regulations. Instead, it attempted to settle the effect of the TEFRA proceeding on the liability of all the individual partners. *Id*.

[51] Tax Notes Document No. 2019-4901 (Jan. 30, 2019).

[52] *BASR Partnership*, 915 F3d 771 (Fed. Cir. 2019).

[53] 28 U.S.C. §2412(d)(2)(B) (emphasis added by Court of Appeals).

[54] *Hurford Investments No. 2. Ltd.*, Docket No. 23017-11, Order dated Sep. 11, 2019.

[55] *Hurford Investments No. 2. Ltd.*, Docket No. 23017-11, Order dated Sep. 11, 2019; Slip Copy at 4.

[56] *Hurford Investments No. 2. Ltd.*, Docket No. 23017-11, Order dated Sep. 11, 2019; Slip Copy at 4–6.

[57] *Hurford Investments No. 2. Ltd.*, Tax Court Docket No. 23017-11, Order dated Sep. 11, 2019; Slip Copy at 6.

[58] *See*, *e.g.*, *Champions Retreat Golf Founders, LLC*, TC, 116 TCM 262, Dec. 61,260(M), TC Memo 2018-146.

[59] Code Sec. 6662; Code Sec. 6662A. This is consistent with the IRS's internal guidance to Revenue Agents, which directs them to assert a "tiering of proposed penalties with multiple alternative positions." *See* Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), at 77.

[60] Tax Court Rule 142(a); *Greenberg's Express, Inc.*, 62 TC 324, Dec. 32,640 (1974).

[61] There is a position that an FPAA with insufficient detail serves to shift the burden to the IRS. *See* Code Sec. 7522 and *J.D. Shea*, 112 TC 183, Dec. 53,318 (1999).

[62] Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), at 78–81.

[63] *Little Horse Creek Property, LLC*, Docket No. 7421-19.

[64] *Little Horse Creek Property, LLC*, Docket No. 7421-19, letter from IRS counsel dated Sep. 4, 2020 (internal citations omitted).

[65] *See*, *e.g.*, IR-2020-188 (Aug. 24, 2020) (attaching a memorandum from the IRS Deputy Commissioner for Services and Enforcement called *Interim Guidance on Designation of Cases for Litigation*); IR-2019-182, *IRS Increases Enforcement Action on Syndicated Conservation Easements*, Nov. 12, 2019; IR-2019-213, *IRS Continues Enforcement Efforts in Conservation Easement Cases Following Latest Tax Court Decision*, Dec. 20, 2019; Nathan J. Richman, *Multiple Divisions Coming for Syndicated Conservation Easements*, TAX NOTES TODAY (Nov. 13, 2019); William Hoffman, *Conservation Easement Crackdown a Portent, Rettig Says*, TAX NOTES TODAY (Nov. 14, 2019); Kristen A. Parillo, *IRS Is Building Up Its Easement Toolbox*, TAX NOTES TODAY (Nov. 15, 2019); Kristen A. Parillo, *IRS Looking for Promoter Links as Easement Crackdown Grows*, TAX NOTES TODAY, Doc. 2019-47134 (Dec. 13, 2019); Tax Notes Doc. 2020-3440 (Jan. 22, 2020) (consisting of LB&I-20-0120-001); Kristen A. Parillo, *IRS Assigns Point Person on Promoter Investigations*, FEDERAL TAX NOTES TODAY, Doc. 2020-6890 (Feb. 25, 2020); IRS News Release IR-2020-49 (Mar. 5, 2020).

[66] Code Sec. 6221(a) (as enacted under the BBA); Reg. §301.6221(a)-1(a).

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