

Alert | Tax Audits, Litigation & Criminal Tax Defense



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U.S. Tax Court Invalidates Conservation Easement Notice, Abates Reportable Transaction Penalty for Failure to Comply with Administrative Procedure Act

In *Green Valley Investors, LLC, Et Al., Bobby A. Branch, Tax Matters Partner, v. Commissioner*,¹ the Tax Court on Nov. 9 abated Internal Revenue Code (I.R.C.) § 6662A penalties asserted against four LLCs because Notice 2017-10, which made syndicated conservation easements listed transactions, failed to comply with the Administrative Procedure Act (APA). The Tax Court followed the Sixth Circuit's reasoning in *Mann Construction, Inc. v. U.S.*² and concluded that the IRS must comply with the APA's notice-and-comment procedures in identifying listed transactions. (For a more detailed explanation of the *Mann Construction* ruling, see [GT Alert, 6th Circuit Rules IRS Must Follow Administrative Procedure Act in 'Listing' Transactions, Raising Questions on Extent of Case's Application.](#)) The IRS's identification of listed transactions has multiple legal consequences: (i) it imposes reporting and recordkeeping obligations on taxpayers and material advisors; (ii) the failure to disclose a listed transaction may result in the imposition of significant penalties; and (iii) the failure to disclose a listed transaction extends the statute of limitations on assessment. Because the IRS historically has not applied the notice-and-comment procedure in identifying listed transactions, *Green Valley Investors* may have widespread implications.

¹ 159 T.C. No. 5 (2022).

² 27 F.4th 1138 (6th Cir. 2022).

Background

During 2014 and 2015, four LLCs granted conservation easements to Triangle Land Conservancy. Each LLC reported a charitable deduction on its Form 1065. Subsequently, the IRS issued Notice 2017-10, identifying all syndicated conservation easement transactions entered into on or after Jan. 1, 2010, as listed transactions for purposes of Treas. Reg. § 1.6011-4(b)(2). On audit, the IRS disallowed the LLCs' charitable deductions and asserted multiple penalties. The Tax Court's ruling concerns application of the reportable transaction penalty under I.R.C. § 6662A.

Under section 6662A, the IRS may impose a penalty equal to 20% of a reportable transaction understatement. The penalty is increased to 30% where a taxpayer fails to disclose the transaction in accordance with I.R.C. § 6664(d)(3)(A) and the applicable Treasury Regulations. Section 6662A applies to listed transactions. The issue in *Green Valley Investors* was whether the IRS followed the correct procedure in identifying syndicated conservation easement transactions as listed transactions for purposes of applying the section 6662A penalty.

The U.S. Tax Court's Analysis

The taxpayers argued that section 6662A could not apply retroactively because Notice 2017-10 was issued after the taxpayers' 2014 and 2015 tax returns were filed. Although the Tax Court has previously upheld the retroactive application of penalties in other cases, it declined to rule on this issue. The Tax Court instead focused on whether Notice 2017-10 complied with the APA.

The IRS did not dispute that it failed to follow the notice-and-comment procedures when it issued Notice 2017-10. Rather, the IRS argued the notice-and-comment procedures were inapplicable on two grounds: (i) Notice 2017-10 was an interpretive rule instead of a legislative rule; and (ii) even if Notice 2017-10 was a legislative rule, Congress did not intend that the APA notice-and-comment procedures apply to the identification of listed transactions. The Tax Court rejected both arguments.

1. Notice 2017-10 Is a Legislative Rule.

First, citing *Mann Construction*, the Tax Court concluded that Notice 2017-10 was a legislative rule. According to the Tax Court, the identification of syndicated conservation easement transactions as listed transactions imposed the following substantive reporting obligations:

- **Taxpayers:** Taxpayers must disclose their participation in syndicated conservation easement transactions on Form 8886. Failure to do so may result in substantial penalties: (i) a penalty under I.R.C. § 6707A for failing to disclose a reportable transaction; (ii) enhanced accuracy-related penalties under I.R.C. § 6662; and (iii) the reportable transaction penalty under section 6662A.
- **Material Advisors:** Material advisors must disclose reportable transactions on Form 8918. A material advisor's failure to disclose reportable transactions may result in a penalty under I.R.C. § 6707. Material advisors also must maintain lists of persons who they have advised on reportable transactions. Failure to produce the list upon request from the IRS may result in a penalty under I.R.C. § 6112.

Therefore, the Tax Court concluded that the IRS had no basis for treating Notice 2017-10 as an interpretive rule.

2. Notice 2017-10 Is Not Exempt from APA Notice-and-Comment Procedures

Next, the Tax Court rejected the IRS argument that Congress exempted the IRS from the APA's notice-and-comment procedures when it enacted I.R.C. § 6707A. The APA provides that it may only be modified by express statutory language.³ Courts have held that there must be an express indication of Congressional intent to override APA provisions. According to the Tax Court, I.R.C. § 6707A does not include express language exempting the IRS from the APA. Moreover, there was no evidence that Congress ratified the IRS actions by failing to act on the APA violations.

The Tax Court ultimately held that the LLCs were not liable for the section 6662A penalties because Notice 2017-10 did not comply with the APA.

Conclusion

Green Valley Investors underscores the importance of complying with the APA notice-and-comment procedures in identifying listed transactions. Taxpayers and material advisors with current disclosure requirements or who have been penalized for participating in listed transactions may wish to consult with their tax advisors about how *Green Valley Investors* affects them.

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³ 5 U.S.C. § 559.

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