The Tax Court Gives a Primer on Listed Transactions while Invalidating the Conservation Easement Listed Transaction Notice

by Robert S. Horwitz

The Supreme Court emphasized that it was not inclined "to carve out an approach to administrative review good for tax law only" in *Mayo Found. for Med. Educ. & Rsch. v. United States*, 562 U.S. 44, 55 (2011). That the IRS is subject to the Administrative Procedures Act (APA) in the same way as other administrative agencies has become increasingly clear. In *CIC Services, LLC v. IRS*, 141 S.Ct. 1582 (2021), the Court held that a material advisor can maintain an action challenging the IRS's listed transaction notice for micro-captive insurance companies as violative of the APA. Earlier this year, the Sixth Circuit in *Mann Construction, Inc. v. United States*, 24 F.4th 1138 (6th Cir. 2022), held that Notice 2007-83, designating as a listed transaction certain employee-benefit plans involving life insurance policies, was invalid because it was issued in violation of the APA's notice-and-comment rulemaking requirements.

It was inevitable that the issue would be the subject of a Tax Court opinion, which it is in *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5 (Nov. 9, 2022). In fact, it was the subject of five opinions: the majority opinion, two concurring opinions and two dissenting opinions. The years in issue were 2014 and 2015. The opinion resulted from cross-motions for partial summary judgment on whether the petitioner was liable for reportable transaction penalties under IRC §6662A in four consolidated conservation easements.

The focus of the opinion was the validity of IRS Notice 2017-10, which made syndicated conservation easements "listed transactions." Petitioner argued that the penalty could not be asserted (i) because any assessment would be a retroactive application of Notice 2017-10, since it was issued after the returns were filed for the years in issue; and (ii) Notice 2017-10 failed to comply with the notice and comment requirements of the APA.

Noting that it had previously upheld the retroactive application of penalties, the Tax Court stated that there was no need to decide the retroactivity issue in the cases before it since it determined that the Notice was invalid for failing to comply with the APA's notice and comment requirements.

Before discussing the Court's five opinions, a little background on listed transaction notices. In its never-ending fight for truth, justice and the maximization of the revenue, the IRS has been playing whack-a-mole with tax shelters since the earliest days of the income tax. It began issuing guidance about transactions it considered abusive tax avoidance transactions in 1990, with Rev. Rul. 90-105, dealing with deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the taxable year. IRS guidance on listed transactions is available online at https://www.irs.gov/businesses/corporations/listed-transactions.

By the beginning of 2000, the IRS had issued guidance designating five additional transactions abusive and, in 2000, designated them as "listed transactions." In that year, temporary and proposed regulations were issued under §6011 that, among other things, identified

six types of "reportable transactions," one of which was a "listed transaction," and required taxpayers to provide information about reportable transactions they engaged in. Final regulations were issued in 2003. Treas. Reg. §1.6011-4(b)(2) defines "listed transaction" as

> …a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service has determined to be a tax avoidance transaction and identified **by notice, regulation, or other form of published guidance** as a listed transaction.

I am emphasizing words that were the lynchpin of the Commissioner's argument.

In 2004 Congress enacted the American Jobs Creation Act (AJCA), Pub. L. 106-357. The AJCA added a number of provisions to the Internal Revenue Code to combat abusive tax shelters. These included:

1. Sec. 6662A, the penalty at issue in the case, which imposes enhanced penalties if the taxpayer's treatment of a listed transaction is determined to be incorrect. The penalty can be imposed even if there is no tax deficiency, since it is based on the "reportable transaction understatement amount," which is the hypothetical tax that could have been avoided, based on the highest rate of tax that could be imposed. The penalty is 20% of this hypothetical tax, but if the transaction was not disclosed, the penalty is 30%.
2. Sec. 6707A, which imposes a penalty for failure to disclose information about a listed transaction, which is defined as "a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of Sec. 6011." The minimum penalty is $10,000 and the maximum penalty is 75% of the decrease in tax resulting from the transaction, not to exceed $200,000.
3. Amended §6707 to impose a penalty upon a material advisor who fails to report a listed transaction or provides false or incomplete information. The amount of the penalty is $50,000 for reportable transactions. For listed transactions it is the greater of $200,000 or 50% of the gross income derived by the material advisor with respect to the listed transaction. Where the failure or act was intentional, the amount is 75% instead of 50% of gross income.
4. Sec.6708, which imposes a penalty upon a material advisor who fails to furnish the list of information required to be maintained under §6011 within 20 business days after it is requested by the IRS. The penalty is $10,000 a day until the list is provided.

Between 2000 and the effective date of the ACJA, the IRS had designated an additional 25 transactions as "listed transactions," primarily through notices published in the Internal Revenue Bulletin. Since the effective date of the ACJA, five additional transactions have been identified as listed transactions. While some listed transactions were identified in Treasury Regulations and revenue rulings, 22 have been identified by notice. The most recent listed transaction notice is 2017-10.

The majority opinion began by listing the APA's "three-step" rulemaking process: (i) issue general notice of rulemaking; (ii) allow interested parties an opportunity to "participate," i.e., comment on the proposed rule; and (iii) include in the final rule a "concise and general statement of [its] basis and purpose." The notice and comment rulemaking procedures do not apply to interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice. They do apply to what are termed "legislative rules." The first issue addressed by the majority was whether the Notice 2017-10 was an interpretive or a legislative rule. This part of the majority's opinion was not disputed by either the concurring or the dissenting opinions.

Legislative rules impose new rights or duties and change the legal status of regulated parties while interpretive rules either articulate what the agency thinks a statue means or remind parties of pre-existing duties. Interpretive rules do not have the force or effect of law. Legislative rules do.

Identifying a transaction as a listed transaction "by its very nature, is the creation of a substantive (i.e., legislative) rule and not merely an interpretive rule." In a footnote the Court stated it was not deciding whether the listed transaction notices and revenue rulings issued pre-AJCA were substantive rulings or whether the AJCA was intended to exempt them from notice and comment rulemaking procedures.

Identifying a transaction as a listed transaction imposes reporting obligations on taxpayers who participated in such transactions. Taxpayers are required to file Form 8686, Reportable Transaction Disclosure Statement, with their returns, which required disclosing the transaction and providing detailed information about the transactions and parties involved. If a transaction is designated a listed transaction after the taxpayer files the return, an amended return must be filed with a Form 8686. The taxpayer is also required to transmit a copy of the Form 8686 to the IRS Office of Tax Shelter Analysis. This reporting obligation continues until the statute of limitations for the filed return expires. If the statement is not filed with the return, the statute of limitations is extended for until one year after the transaction is disclosed.

The Court discussed the fact that failing to report a listed transaction can result in penalties under §6707A and that the penalty applies even if it is ultimately determined that the taxpayer's treatment of the transaction on a tax return was correct. A taxpayer who is required to file reports with the SEC must disclose any listed or reportable transaction penalties. A taxpayer who engaged in a listed transaction is also subject to enhanced penalties under §6662A if the treatment of the transaction is determined to be incorrect.

Material advisors, as defined in §6111(b)(1)(A), are required to file a return with detailed information about the transaction on Form 8918, Material Advisor Disclosure Statement. Like the taxpayer disclosure statements, Form 8918 requires detailed information about the transactions and the persons and entities involved. Material advisors are also required to maintain lists that must include information about each reportable transaction and the participants and must also retain copies of various documents relating to each reportable transaction they advised on. Failure to disclose required information or providing false or

incomplete information exposes a material advisor to penalties under §6707. Failure to furnish lists when requested by the IRS exposes a material advisor to penalties under §6708.

Because the IRS's identification of a transaction as a "listed transaction" imposes increased reporting obligations on both taxpayers and material advisors and exposes both taxpayers and advisors to monetary penalties, Notice 2017-10 is a legislative ruling.

The Court then turned to the question at the heart of the case: did Congress intend to exempt the procedure for designating listed transactions from APA's notice-and-comment rulemaking procedures? The majority answered "no."

APA §559 requires any exemption from APA procedures to be done "expressly." Exemptions by implication is disfavored and are only found where the provisions of two statutes are irreconcilable or where the later act is clearly intended as a substitute for the earlier act. The Supreme Court has described the necessary indicia of Congressional intent by the terms "necessary implication," "clear implication," and "fair implication." In prior cases, courts had found an exception to APA rulemaking procedures when there were irreconcilable differences between the APA and the law in question.

The Court noted that to buttress its argument, the Commissioner relied on the text of §6707A, Treas. Reg. §1.6011-4, other AJCA provisions, and the context and legislative history or the AJCA. Turning to the language of §6707A, the Court noted that it does not contain any express indication Congress intended to exempt the IRS from notice-and-comment rulemaking. Thus, the text of the statute did not support the IRS. As to the argument that Treas. Reg. §1.6011-4(b)(2) apprised Congress that the IRS would identify listed transactions without notice and comment and in defining listed transactions Congress incorporated this procedure, the Court commented that it was not clear Congress understood that the reference "notice" in the regulation was a clearly defined procedure for identifying listed transactions. Reference in the AJCA to the §6011 regulations does not suggest otherwise.

Quoting *Mann Construction, supra*, the Court said the text of §6707A(c) only "addressed a 'which transaction' question, not a 'what process' question." According to the Court, the reference to the Treas. Reg. §6011 regulations "does not establish an express congressional intention to displace fundamental APA principles for future reportable transactions." Additionally, §6707A "does not reference any procedures whatsoever" and the AJCA can be reconciled with the APA, since the AJCA "merely establishes a disclosure and penalty regime to be administered by the IRS."

According to the Court, reading the statutory text in conjunction with Treas. Reg. §1.6011-4 does not support the IRS since it is "not concerned with setting up processes but rather is directed to naming categories of transactions subject to IRS reporting requirements." The Court was convinced the phrase "as determined" clause in §6707A was intended to coexist with APA rulemaking procedures "and for the IRS to identify future reportable transactions with the APA's ordinary regime of notice and comment."

While Congress understood the IRS had identified listed transactions before the AJCA, and it acknowledges the IRS's disclosure framework, the Court does not accept the argument

that the ACJA represented a "blanket approval" of the IRS's method of identifying a syndicated conservation easement as a listed transaction in Notice 2017-10 without notice and comment.

Relying again on the *Mann Construction* case, the Court rejected the Commissioner's contention that Congress was presumptively aware of IRS actions when it added the listed transaction penalties under §6707A. Congress was also aware that it had to expressly exempt an agency from APA requirements. Nor can subsequent Congressional inaction be interpreted as an endorsement of IRS practice. The Court refused to presume that Congress expected any future additions or amendments to the "listed transaction regime" would be made without notice and comment. Similarly, continued Congressional oversight of syndicated conservation easement transactions did not show Congress intended to exempt the listed transaction regime from APA procedures.

The Court concluded that it was not convinced that Congress expressly authorized the IRS to identify syndicated conservation easements as listed transactions without the APA's notice and comment procedures. In a footnote, the Court stated that it intended to apply its decision to all similarly situated taxpayers in cases before it.

Judge Pugh concurred with the result. She agreed with the Court's determination that Notice 2017-10 is a legislative rule that is subject to APA procedures unless exempted. She wrote that the Court's task should be to "read the later statute (section 6707A) and determine whether its plain import directly conflicts with an earlier statute (5 USC §553(b)). Stated differently, in this case we must decide 'whether Congress has established procedures so clearly different from those required by the APA that it must have intended to displace the norm.'" Some statutes have procedures that were "irreconcilable with the APA" while others have procedures that can coexist with the APA."

Judge Pugh noted that there was "little doubt" that Congress "knew about and endorsed the existing administrative procedure for determining reportable transactions and identifying listed ones" by defining reportable transactions and listed transactions by reference to IRS determinations under the 6011 regulations. This procedure is "identification by notice, regulation or other form of published guidance." She noted that unlike the majority, she was more confident that Congress understood that the IRS had identified and would continue to identify listed transactions, "perhaps even by issuing notices." She faulted the majority for failing to follow the statute to where it led, which was the §6011 regulations. This implies that Congress cannot adopt procedures by reference in a statute. She thus saw the question of whether, in adopting this procedure by reference, Congress intended to displace the APA notice and comment procedures.

The procedure Congress adopted by reference to identify listed transactions "by notice, regulation, or other form of published guidance" can, by its terms, be reconciled with, and did not directly conflict with, the APA. Finally, Judge Pugh noted that if notice-and-comment rulemaking impedes the IRS's ability to identify potentially abusive transactions, the APA allows the IRS to invoke the good cause exception, as it did when issuing the Son of BOSS regulations.

Judge Toro concurred in the result but wrote a concurring opinion "to offer a few observations on the extent to which section 6707A might be viewed as incorporating the 2003 regulation, given the focus on this issue by the parties and my colleagues." While agreeing with the Commissioner that Congress meant to incorporate to some extent the structure that Treasury and the IRS had established in the new penalty regime, this was not enough to determine what Congress incorporated. This required an examination of the statutory language. Judge Toro noted that the definition of "listed transaction" was a reportable transaction "specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011." The definition of reportable transaction was one with respect to which information is required "as determined under regulations prescribed under section 6011" that have the potential for tax avoidance or evasion. Neither §6662A nor §6707A refer to the APA. The statue does not address how listed transactions are to be identified. Further, the authority to require certain information to be reported will be exercised "as determined under" §6011 regulations. Nothing in the statute "expressly turns off the APA requirements that would otherwise govern the Secretary's designation of a listed transaction" and nothing in the text implies that APA requirements do not apply.

Judge Toro then focused on the fact that the reference to the regulations was in the definition of "reportable transaction" but not the definition of "listed transaction," which was the most important term in deciding the case, since the AJCA penalty regime applies to listed transactions. Furthermore, the 2003 regulations focused on the characteristics of reportable transactions and not on the process for identifying them. The only language that was "process focused" was the phrase "by notice, regulation, or other form of published guidance" for identifying listed transactions. The definition of listed transaction in §6707A did not contain this phrase, just as it did not reference the regulations. The statute's omission of any procedural words in its definition of listed transaction "disinclined" Judge Toro to read §6707A(c)(1) as adopting "a back-door way of establishing a process" for identifying listed transactions. Thus, he agreed with the Court's opinion on the disposition of the §6662A penalty issue.

In his dissent, Judge Gale agreed with Judge Pugh on the test to apply, but applied it differently. According to Judge Gale, identification of a listed transaction "by notice" could not be reconciled with APA notice-and-comment rulemaking for the simple reason that the well-established procedure for issuing notice by the IRS did not involve the notice-and-comment procedures. In referencing the §6011 regulations, Congress did not intend a significant modification of the procedure for issuing guidance by notice. This convinced him that Congress, by incorporating the regulations into the statute, intended to displace APA notice-and-comment rulemaking.

Judge Gale found further support in the conference report concerning the subsequently enacted §4965, which imposes an excise tax on exempt entities and their managers for participating in listed transactions, which the report stated were "identified by notice, regulation, or other forms of published guidance" as such.

Judge Nega also dissented. He argued that the majority's holding "is worryingly close to a standard requiring 'magical passwords in order to effectuate an exemption'" from the APA. In

his view, Congress was aware of the IRS's rulemaking in this area when it enacted the ACJA to bolster those efforts by adding a penalty regime. The cross-reference in the statute to the §6011 regulations "constitutes strong textual evidence of Congress' intent to replace the ritual application of the APA in this area."

Given the majority's opinion, it is probable that the Tax Court will invalidate the post-AJCA listed transaction notices, all of which were issued without APA notice-and-comment. How it will view pre-AJCA listed transaction notices, assuming a case involving one of those transactions comes before it, is unclear. What is clear, however, is that any practitioner who represents clients before the IRS should become familiar with the APA.

Robert S. Horwitz is a Principal at Hochman Salkin Toscher Perez P.C., former Chair of the Taxation Section, California Lawyers' Association, a Fellow of the American College of Tax Counsel, a former Assistant United States Attorney and a former Trial Attorney, United States Department of Justice Tax Division. He represents clients throughout the United States and elsewhere involving federal and state administrative civil tax disputes and tax litigation as well as defending clients in criminal tax investigations and prosecutions. In 2022 the Tax Section of the California Lawyers Association awarded him the Joanne M. Garvey Award for lifetime achievement in and contributions to the field of tax law. Additional information is available at http://www.taxlitigator.com.