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In this article, Amin and Young question the independence of the IRS Independent Office of Appeals by analyzing its failure to resolve syndicated conservation easement cases without litigation.

The IRS Office of Appeals has existed — albeit with different names — since 1927.[1] The 2019 Taxpayer First Act added the word "independent," making it the Independent Office of Appeals. The mission of Appeals is to resolve federal tax controversies without litigation on a basis that is fair and impartial to both the government and the taxpayer.[2] The hallmark of Appeals, and one of the reasons "independent" was added to its official name, is that it is meant to be "an independent function within the IRS, completely separate from the compliance functions responsible for collecting and assessing taxes."[3]

The path to Appeals depends on the type of case at issue. Generally, a taxpayer can contest a deficiency in Appeals after an examination concludes. Alternatively, a taxpayer can file a petition in Tax Court and then come back to Appeals through the docketed case process.[4] Regardless of a taxpayer's route, Appeals is supposed to act independently and "offer taxpayers a fair settlement based on the probable outcome if their case were to go to court," that is, Appeals' settlement offer should reflect the hazards of litigation.[5] Thus, Appeals officers should be unbiased and consider the strengths and weaknesses of the government's and the taxpayer's cases and attempt to reach a fair and impartial settlement.

Congress intended for Appeals to resolve federal tax controversies without litigation by fairly and impartially reviewing each party's case, consistently applying and interpreting federal tax laws, and acting as an independent forum in which taxpayers could resolve their disputes with the IRS.[6] But is Appeals truly independent? When it comes to syndicated conservation easement cases, we believe the answer is a resounding no.

Appeals' Conservation Easement Problem

It's no secret that the Tax Court is overwhelmed by the number of conservation

[1] Andrew Strelka and Sean Morrison, "The IRS and America's Longest Running ADR Program," *The Federal Lawyer* (Oct./Nov. 2016).

[2] H.R. Rep. No. 39 Part 1, 28-29, n.4 (2019).

[3] Andy Keyso, "A Closer Look at the IRS Independent Office of Appeals," IRS.gov (last updated Nov. 18, 2022).

[4] *See* section 7803(e)(4); *see also* Rev. Proc. 2016-22, 2016-15 IRB 577, section 3.04.

[5] Keyso, *supra* note 3.

[6] Section 7803(e)(3).

easement cases on its docket. Some estimate this number to be over 750, with many more to soon come.[7] It would take the Tax Court decades to fully try and issue opinions on all these cases. For many taxpayers, cases end up in a circuit court of appeals, which will only extend the timeline for resolving the universe of conservation easement cases.

One has to ask: If the mission of Appeals is to resolve cases without litigation, why are there so many easement cases docketed in Tax Court if all docketed cases should go through Appeals? The answer is either that there are a significant number of cases that have already settled in Appeals or Appeals isn't settling cases at all.[8] A review of the Tax Court docket suggests the latter. While Appeals generally settles many other cases, it does not offer fair and impartial settlements in conservation easement cases.

A quick review of IRS published guidance shows that it is difficult for Appeals to be independent from IRS Exam and the Office of Chief Counsel. For example, Rev. Proc. 2016-22 allows Appeals to obtain advice from chief counsel and consider that advice in making settlement offers in docketed conservation easement cases.[9] Appeals obtaining and considering advice from chief counsel in making a settlement offer suggests that Appeals is an arm of chief counsel rather than an independent group within the IRS. Further, it does not appear that there is any requirement for Appeals to provide taxpayers with any advice that Appeals obtains from chief counsel. Further, the IRS's ex parte communication rules do not apply to communications between Appeals and chief counsel concerning docketed Tax Court cases.[10] It is hard to imagine that Appeals can fairly and impartially review a taxpayer's docketed case when it can obtain advice from, and communicate with, chief counsel regarding docketed Tax Court cases in which chief counsel is directly opposed to the taxpayer. Congress could not have foreseen Appeals' lack of independence from chief counsel when enacting section 7803(e) in 2019.

Appeals Does Not Assess Hazards

Appeals is supposed to attempt settlements based on the probable outcome of a case if it were to go to court.[11] That means Appeals must consider the facts of a case together with the relevant case law to determine a reasonable and impartial settlement offer. With certain issues, case law and statutory and regulatory guidance may be clear and lean heavily in one direction. For example, the IRS has won four microcaptive cases[12] in Tax Court with taxpayers having won none. So the hazards of litigation clearly lie (at least in the eyes of Appeals) with taxpayers on this issue. Thus, the burden is on taxpayers to convince Appeals that their microcaptive cases are sufficiently dissimilar to recent government-favorable case law.

However, conservation easement case law is not as predetermined. In some ways, it is more taxpayer-favorable than government-favorable. We know that Appeals admits as much because during Appeals conferences it often concedes that the government has the hazards on most, if not all, of the section 170 issues. All that often remains is the issue of valuation — an almost purely factual issue. And both taxpayers and the government have won on valuation. For example, in *Champions Retreat*,[13] the Tax Court awarded the taxpayer approximately 75 percent of its claimed

[7] Armando Gomez and Roland Barral, "It's High Time to Clear Out the Tax Court's Easement Backlog," *Tax Notes Federal*, Apr. 10, 2023, p. 251.

[8] Other potential answers could be that chief counsel is refusing to refer cases to Appeals or is moving to calendar cases for trial and immediately requesting the cases back from Appeals after the cases are placed on a trial calendar. *See* Rev. Proc. 2016-22, section 3.03 (providing IRS chief counsel discretion to deny a taxpayer its section 7803(e) right to Appeals), and section 3.07 (providing that Appeals "will return the case to Counsel . . . within 10 calendar days after the case appears on a trial calendar"). *See also Toscano Holdings LLC v. Commissioner*, No. 12214-20, Tax Court petition for readjustment of partnership items (Oct. 8, 2020).

[9] Rev. Proc. 2016-22, section 3.14.

[10] IRM 8.1.10.4.1.5(1).

[11] Taxpayer Advocate Service, "Appeals Considers Risk of Going to Court (Hazards of Litigation)" (Apr. 12, 2022); *see also* IRM 8.6.1.7.2(2)-(3) (providing generally that Appeals will attempt to settle cases based on hazards of litigation).

[12] *Avrahami v. Commissioner*, 149 T.C. 144 (2017), *Reserve Mechanical Corp. v. Commissioner*, T.C. Memo. 2018-86, *aff'd*, 34 F.4th 881 (10th Cir 2022), *Syzygy Insurance Co. Inc. v. Commissioner*, T.C. Memo. 2019-34, *Caylor Land & Development Inc. v. Commissioner*, T.C. Memo. 2021-30.

[13] *Champions Retreat Golf Founders LLC v. Commissioner*, 124 T.C. Memo. 2022-106.

deduction based in part on expert witness testimony regarding valuation. In *Palmer Ranch*[14] and *Rajagopalan*,[15] the Tax Court approved the deduction claimed on the return.

Because case law on section 170 issues favors taxpayers and case law on valuation goes both ways, Appeals should theoretically be making taxpayer-favorable offers in some cases. However, that is not happening. A review of the docketed cases indicates that the IRS has determined the value of almost all easements to be zero or near zero — and Appeals agrees. Offers from Appeals are therefore being rejected for being too low. Unfortunately, the IRS has been taking this approach for nearly 40 years.[16]

Taxpayers certainly have the hazards on valuation in some cases, and Appeals has the very difficult job of analyzing complex facts along with the breadth of case law in the area. But that doesn't mean Appeals should make nuisance offers in almost every case. In most of these cases, the examination team does not conduct an in-depth review of the taxpayer's appraisal. In some cases, a revenue agent who is not a qualified appraiser is the sole person reviewing the taxpayer's appraisal. Yet somehow, according to Appeals, the taxpayer still bears almost all of the hazards on valuation.

If Appeals was serious about evaluating the hazards of litigation for conservation easement cases, it wouldn't be making nuisance offers in the majority of cases. The only explanation for this is that Appeals isn't truly independent of other IRS functions — instead, its decisions are being guided by higher-level (Appeals or non-Appeals) officials.[17]

Appeals Does Not Budge on Penalties

Appeals is no more generous with penalties, regularly claiming that its hands are tied. When the exam team asserts the 40 percent gross valuation misstatement penalty, Appeals almost always claims that it does not have authority to settle for less than the full penalty because it is computational. Yet, Internal Revenue Manual 20.1.1.4.1(4) provides, "Appeals has the authority to settle penalties for less than the full amount based on hazards of litigation," and IRM 8.11.1.2.7.5(1) provides, "penalties may be settled based on hazards of litigation."

It is perplexing that Appeals is not using its authority to settle penalties in conservation easement cases even though it has the authority to do so and the hazards of litigation favor the taxpayers. Even in microcaptive cases, Appeals is willing to reduce the 40 percent noneconomic substance penalty to try to resolve cases. But in valuation cases, it refuses to exercise this discretion. Taxpayers and practitioners can only assume that Appeals has been instructed not to settle penalties in conservation easement cases because there is no published guidance regarding the Appeals coordinated issue process for conservation easements.[18]

Certainly the backlog of conservation easement cases in Appeals and the Tax Court could be reduced if Appeals used its authority to settle penalties such as the gross valuation misstatement and substantial valuation misstatement penalties for less than the full amount. However, Appeals is taking a one-size-fits-all approach to conservation easement cases and does not consider reducing penalties even when the hazards of litigation favor the taxpayer.

The problem is not confined to valuation penalties. Appeals is refusing to settle section 6662A penalties for failure to file Forms 8886, "Reportable Transaction Disclosure Statement." A recent conversation with IRS technical guidance suggests that Appeals officers and technical

[14] *Palmer Ranch Holdings Ltd. v. Commissioner*, T.C. Memo. 2016-190.

[15] *Rajagopalan v. Commissioner*, T.C. Memo. 2020-159.

[16] See comment dated Sept. 12, 1984, to notice of proposed rulemaking, LR-200-76, 48 F.R. 22940 (May 23, 1983) ("Easement donations are deductible, yes; but they're all worth zero. So the IRS is saying.").

[17] This issue is not limited to conservation easement cases. In a recent case, an Appeals officer proposed a settlement offer in which the taxpayer would receive a substantial refund, but the officer reversed course at the last minute and instead proposed a settlement requiring the taxpayer to pay millions of dollars in taxes, penalties, and interest. As the Appeals officer withdrew the settlement offer providing a refund without any explanation, it appears likely that some higher-level IRS official determined that the taxpayer should not be entitled to a refund.

[18] In testimony before his confirmation, IRS Commissioner Daniel Werfel expressed concern with a one-size-fits-all approach to resolving taxpayer issues for coordinated issue cases. *See* Senate Finance Committee, "Finance Committee Questions for the Record, Hearing on the Nomination of Daniel Werfel, Responses by Daniel Werfel" (Feb. 24, 2023).

guidance are not permitted to make settlement offers because of the uncertain status of Notice 2017-10, 2017-4 IRB 544. Recall that this notice was set aside by the Tax Court in *Green Valley*[19] and a federal district court in *Green Rock*.[20] With the notice set aside by the Tax Court and a district court,[21] there is no uncertainty — the hazards lie solely with the government.[22] But Appeals seems to be waiting for an appellate court decision, which could take years. If Appeals was truly independent, it wouldn't wait for potentially government-favorable case law and would instead acknowledge that the hazards today lie with the government and apply the law to the facts fairly and impartially.

Conclusion

Taxpayers have lost all confidence in Appeals' independence because it is not operating as Congress intended. Appeals routinely communicates with and relies on chief counsel in docketed conservation easement cases and refuses to negotiate penalties at all. If taxpayers cannot trust that Appeals will be independent and fairly and impartially consider their cases, then what is the purpose of Appeals?

Given Appeals' approach to conservation easement cases to date, taxpayers have sought out mediation to obtain independent, fair, and impartial opinions about their cases. One glimmer of hope remains — the confirmation of a new commissioner who appears intent on ensuring that Appeals fulfills its purposes and duties as outlined by Congress. It remains to be seen whether IRS Commissioner Daniel Werfel will make substantive changes to Appeals' operating procedures for conservation easement cases or maintain the status quo. The latter will drive taxpayers further away, while substantive changes remain taxpayers' last hope for an independent Office of Appeals. ■

[19] *Green Valley Investors LLC v.* Commissioner, 159 T.C. 80 (2022).

[20] *Green Rock LLC v. IRS*, No. 2:21-cv-01320 (N.D. Ala. Feb. 2, 2023).

[21] Treasury has promulgated temporary regulations to revive the reporting requirements, but they have not yet been finalized.

[22] The IRS's appeal of the Northern District of Alabama's decision in *Green Rock* is before the Eleventh Circuit.