

US Tax Court Voids Penalties Affecting Syndicated Conservation Easements; Treasury Reacts With Proposed Regulations

The Tax Court's decision setting aside IRS Notice 2017-10 for ignoring the APA's notice-and-comment requirements has serious implications for other notices identifying listed transactions.

Key Points:

- Notice 2017-10¹ identified syndicated conservation easements as potentially abusive “listed transactions,” with associated reporting responsibilities and an enhanced penalty structure under Section 6662A of the Internal Revenue Code.²
- In [Green Valley Investors, LLC v. Commissioner](#), the Tax Court held that the IRS's listed transaction regime may not bypass the notice-and-comment requirements of the APA.³ Because the IRS failed to follow these requirements with respect to Notice 2017-10, the Tax Court set the listing notice aside.
- In response to this decision, Treasury quickly issued proposed regulations — subject to notice-and-comment procedures — to again identify syndicated conservation easements as listed transactions.
- The *Green Valley Investors* decision charts the course for courts to potentially set aside dozens of IRS notices identifying listed transactions over the last two decades.

Petitioners in *Green Valley Investors* granted conservation easements over real property and claimed related deductions under Section 170 for charitable easement contributions for tax years 2014 and 2015. The Internal Revenue Service (IRS) examined and disallowed the deductions and imposed numerous penalties, including the understatement penalty under Section 6662A. Petitioners challenged the Section 6662A penalty, arguing that Notice 2017-10, which subjected syndicated conservation easements to the penalty, could not be retroactively applied and was issued in violation of the Administrative Procedure Act (APA).⁴

Notice 2017-10, Treas. Reg. § 1.6011-4(b)(2), and Section 6662A Penalties

Syndicated conservation easements have been a longtime target of IRS scrutiny. In 2017, the IRS published Notice 2017-10, stating:

The Treasury Department and the IRS have become aware that some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to claim charitable contribution deductions in amounts that significantly exceed the amount invested. In such a syndicated conservation easement transaction, a promoter offers prospective investors in a partnership or other pass-through entity ... the possibility of a charitable contribution deduction for donation of a conservation easement.

Notice 2017-10 identified all syndicated conservation easement transactions and substantially similar transactions as “listed” tax avoidance transactions. “Listed” transactions are subject to the regulations issued under Section 6011’s “reportable transaction” disclosure regime. Taxpayers who participate in reportable transactions, including listed transactions, must disclose their participation to the IRS.⁵ Material advisors⁶ to reportable transactions must disclose the transactions to the IRS as well.⁷ Material advisors must also maintain lists of the persons whom they advised with respect to the transactions.⁸ Failure to comply with these disclosure requirements subjects taxpayers and material advisors to penalties.⁹

Under Treas. Reg. § 1.6011-4(b)(2), a “listed transaction” is “a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.” Treas. Reg. § 1.6011-4(b)(2) was introduced as a temporary regulation in 2000 and became final in 2003.

In 2004, Congress enacted Sections 6707A and 6662A. Section 6662A imposes enhanced penalties for not complying with the listed transaction and reportable transaction requirements. The Section 6662A penalty imposes a 20% accuracy-related penalty with respect to an understatement of tax attributable to a reportable or listed transaction as defined under Section 6707A. The penalty increases to 30% if the required disclosures affecting such transactions are not satisfied. Section 6662A penalties apply to all listed transactions and to reportable transactions with a significant purpose of avoidance or evasion of federal income tax.

Section 6707A(c) defines both “reportable transactions” and “listed transactions.” Reportable transactions are “a type [of transaction] which the Secretary determines as having a potential for tax avoidance or evasion.”¹⁰ The Secretary “**determines**” whether a transaction is a reportable transaction “**under regulations prescribed under section 6011.**”¹¹ Listed transactions are transactions “specifically **identified** by the Secretary as a tax avoidance transaction for **purposes of section 6011.**”¹² The important distinction here is that Congress drafted Section 6707A so that the reportable transaction regime operates “under” the Section 6011 regulations, whereas the listed transaction regime is not so explicit. This distinction is discussed in more detail in the analysis of the Tax Court’s decision below.

Notice 2017-10 put taxpayers and advisors on notice that the IRS had identified syndicated conservation easements and substantially similar transactions as having a tax avoidance purpose. The notice identified a range of penalties, including the enhanced understatement penalties under Section 6662A, potentially applicable to such transactions. The question presented to the Tax Court in *Green Valley Investors* was whether the issuance of Notice 2017-10 was required to comply with the APA’s notice-and-comment procedures.

The *Green Valley Investors* Decision

On November 9, 2022, the Tax Court granted in part Petitioners’ cross-motions for summary judgment, set aside Notice 2017-10, and prohibited the imposition of Section 6662A penalties. The Tax Court held that the identification of transactions as listed transactions is a form of legislative rulemaking subject to the APA’s notice-and-comment requirements.¹³

Only legislative rules — rules imposing new rights or duties that “change the legal status of the regulated parties” — are subject to notice and comment.¹⁴ Interpretative rules — rules that “merely advise the public of an agency’s construction of the statutes it administers” — are not.¹⁵ Notice 2017-10’s identification of syndicated conservation easement transactions imposed new reporting and recordingkeeping obligations on taxpayers and their advisors and exposed them to penalties for failing to comply. The Tax Court found that Notice 2017-10’s creation of these obligations and exposures make it a “prototype of a legislative rule.”¹⁶ While the Tax Court noted that the APA allows agencies to depart from normal notice-and-comment procedures for good cause,¹⁷ the IRS did not invoke the exception when it issued Notice 2017-10.¹⁸

As explained by the Tax Court, Congress can exempt agency actions from notice and comment, but only if it does so expressly.¹⁹ The Tax Court’s majority rejected the Commissioner’s argument that, through its enactment of Section 6707A, Congress exempted Notice 2017-10 from notice and comment. The Commissioner’s primary argument was that, before Congress enacted Section 6707A, the IRS had issued Treas. Reg. § 1.6011-4(b)(2), defining listed transactions as transactions “identified by notice, regulation, or other form of published guidance.”²⁰ According to the Commissioner, because Section 6707A refers to “regulations prescribed under section 6011” in its definition of reportable transactions, Congress adopted the regulation even with respect to identifying listed transactions.²¹

The Tax Court concluded that this language was not sufficient evidence of Congress’s express intent to deviate from notice and comment.²² The Tax Court was similarly unpersuaded by the Commissioner’s argument that Congress’s knowledge that the IRS had previously identified listed transactions without notice and comment meant that Congress endorsed that practice.²³ Acknowledging that Notice 2017-10 was issued more than a decade after Section 6707A was enacted, the Tax Court found it “inappropriate to assume Congress expected that any subsequent amendment or addition to the listed transaction regime by the IRS would be made without notice and comment under the APA.”²⁴

As a legislative rule that was not excepted from notice-and-comment procedures, the identification of syndicated conservation easements as a listed transaction should have proceeded with:

- a notice of proposed rulemaking;
- an opportunity for comment; and
- a general statement of the final rule’s basis and purpose.²⁵

Because the IRS issued Notice 2017-10 without satisfying these requirements, the Tax Court set the notice aside. It also noted its intent to apply its decision for the benefit of similarly situated taxpayers who come before it.²⁶ Although all but two of the judges joined in the majority decision, the reasoning in the case was far from unanimous, inspiring five written opinions (the majority, two concurrences, and two dissents).

Judge Pugh and those who joined her concurring opinion (Judges Kerrigan and Paris) felt the majority did not ascribe enough significance to Congress’s knowledge of Section 6011’s regulatory procedures at the time it enacted Section 6707A incorporating Section 6011’s regulations.²⁷ Those procedures require that listed transactions be identified “by notice, regulation, or other form of published guidance as a listed transaction.”²⁸ Despite this disagreement, Judge Pugh concurred in the result, emphasizing that the “by notice, regulation, or other form of published guidance” requirement of Treas. Reg. § 1.6011-4(b)(2) can be reconciled with the APA’s notice-and-comment requirement. Judge Toro wrote separately in concurrence, agreeing with the majority’s ruling but disagreeing with its conclusion that Congress’s enactment of Section 6707A(c) incorporated Treas. Reg. § 1.6011-4.²⁹

Judge Gale, in dissent, would have found that “notice” as it appears in Treas. Reg. § 1.6011-4(b)(2) is distinguishable from the APA’s “notice and comment” and that Congress intended the former to replace the latter.³⁰ Judge Nega, in a separate dissent, agreed with Judge Gale and emphasized the importance of Congress’s knowledge at the time it enacted Section 6707A(c).³¹

On December 16, 2022, the IRS filed a motion for the Tax Court to reconsider its decision.

New Proposed Regulations

The *Green Valley Investors* decision is just one of several recent cases involving the IRS’s failure to follow notice-and-comment procedures. Earlier this year, the Sixth Circuit held in *Mann Construction, Inc.* that Notice 2007-83³² — identifying another type of listed transaction — also violated the APA’s notice-and-comment requirement.³³ And in 2019 and 2021, district courts in Colorado³⁴ and the Eastern District of Tennessee³⁵ each found that the IRS had failed to comply with required notice-and-comment procedures when it issued temporary regulations and a listing notice, respectively.

Since the *Green Valley Investors* decision, the IRS has attempted once again to identify syndicated conservation easements as listed transactions — this time in compliance with the APA. On December 8, 2022, the IRS issued a [notice of proposed rulemaking](#) (the Proposed Regulations), with the required opportunity for notice and comment and general statement of the final rule’s basis and purpose. Comments will be accepted through February 6, 2023, and a public hearing will be held on March 1, 2023.

Although the Tax Court made clear that it “intends to apply [the *Green Valley Investors*] decision setting aside Notice 2017-10 to the benefit of all similarly situated taxpayers who come before [it],”³⁶ the notice of proposed rulemaking makes clear that the Treasury Department and the IRS take a different view. First, Treasury and the IRS “are continuing to defend the validity of Notice 2017-10 and other notices identifying transactions as listed transactions in circuits other than the Sixth Circuit.”³⁷ (As noted above, earlier this year in *Mann Construction*, the Sixth Circuit set aside another IRS listing notice because it did not comply with the APA’s notice-and-comment requirements.³⁸) More importantly (for taxpayers in other circuits), Treasury and the IRS expect taxpayers, other than taxpayers in the Sixth Circuit, to continue to comply with disclosure and list maintenance requirements for syndicated conservation easement transactions.³⁹

Once final, the Proposed Regulations would apply to all open tax years, including years that ended before the Proposed Regulations become final.⁴⁰ Additionally, certain material advisors would be required to disclose syndicated conservation easement transactions dating back six years from when the Proposed Regulations become final.⁴¹ Because the Tax Court in *Green Valley Investors* could dispose of the asserted Section 6662A penalties by setting aside Notice 2017-10 on APA grounds, it declined to decide whether Section 6662A penalties could be applied to tax years that were open at the time Notice 2017-10 was issued.⁴² The retroactivity issue could be tested again, given the IRS’s determination to continue to fight for Notice 2017-10’s validity and the potential for the regulations, when finalized, to apply retroactively.

The Fate of Other Listed Transactions

The IRS has identified more than 30 listed transactions “by notice, regulation, or other form of published guidance” over the last 20 years, subjecting taxpayers and advisors involved in those transactions to reporting responsibilities and substantial penalties for noncompliance. Each one of these notices is now subject to a potential challenge on APA grounds.

The notices identifying listed transactions affect not only taxpayers, but also their advisors who may be subject to reporting requirements and penalties. For listed transactions identified by a notice like the one

set aside in *Green Valley Investors*, taxpayers and their advisors are not required to wait until the IRS takes an adverse action with respect to such transactions to challenge them in court.⁴³ In light of *Green Valley Investors* and the other recent taxpayer-friendly decisions discussed above, taxpayers and advisors may begin to challenge each of the 30-plus notices that identified listed transactions without notice and comment — before they are even approached by the IRS.

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Endnotes

¹ 2017-4 I.R.B. 5244 (Jan. 23, 2017).

² Unless otherwise indicated, all references herein to Section and § refer to Title 26 U.S.C., the Internal Revenue Code of 1986, as amended (the Code or I.R.C.), and the Treasury regulations thereunder.

³ *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5 (2022).

⁴ Notice 2017-10 purported to apply to transactions dating back to January 1, 2010. Because it set aside the Notice, the Court did not need to decide whether Section 6662A penalties can be applied retroactively. *Id.* at 7.

⁵ Treas. Reg. § 1.6011-4.

⁶ A material advisor is a person “(i) who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and (ii) who directly or indirectly derives gross income in excess of the threshold amount (or such other amount as may be prescribed by the Secretary) for such aid, assistance, or advice.” I.R.C. § 6111(b)(1).

⁷ I.R.C. § 6111.

⁸ I.R.C. § 6112.

⁹ I.R.C. §§ 6662A, 6707, 6708.

¹⁰ I.R.C. § 6707A(c)(1).

¹¹ *Id.* (emphasis added).

¹² I.R.C. § 6707A(c)(2) (emphasis added).

¹³ *Green Valley Investors*, 159 T.C. No. 5, at 15.

¹⁴ *Id.* at 8–9 (citations and quotations omitted).

¹⁵ *Id.*

¹⁶ *Id.* at 15.

¹⁷ *Id.* at 16 (citing 5 U.S.C. § 553(b)(B)).

¹⁸ *Id.*

¹⁹ *Id.* at 16–18 (citing 5 U.S.C. § 559).

²⁰ *Id.* at 19.

²¹ *Id.*

²² *Id.* at 20.

²³ *Id.* at 21–22.

²⁴ *Id.* at 22.

²⁵ 5 U.S.C. § 553(b)-(c).

²⁶ *Green Valley Investors*, 159 T.C. No. 5, at 23, n.22.

²⁷ *Id.* at 30–31.

²⁸ *Id.*

²⁹ *Id.* at 34–41.

³⁰ *Id.* at 42–44.

³¹ *Id.* at 45–46.

³² 2007-2 C.B. 960.

³³ *Mann Construction, Inc. v. United States*, 27 F.4th 1138, 1148 (6th Cir. 2022).

³⁴ *Liberty Glob., Inc. v. United States*, No. 1:20-CV-03501, 2022 WL 1001568 (D. Colo. Apr. 4, 2022).

³⁵ *CIC Services, LLC v. IRS*, No. 3:17-CV-110, 2021 WL 4481008 (E.D. Tenn. Mar. 21, 2022).

³⁶ *Green Valley Investors*, 159 T.C. No. 5, at 23, n. 22.

³⁷ *Syndicated Conservation Easement Transactions as Listed Transactions*, 87 Fed. Reg. 75185, 75190 (Dec. 8, 2022).

³⁸ *Mann Construction, Inc.*, 27 F.4th at 1148.

³⁹ 87 Fed. Reg. at 75190.

⁴⁰ 87 Fed. Reg. at 75193.

⁴¹ 87 Fed. Reg. at 75193–94.

⁴² *Green Valley Investors*, 159 T.C. No. 5, at 7.

⁴³ *CIC Services, LLC v. IRS*, 141 S. Ct. 1582 (2021).