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**Quoted in Tax Notes Today on Gross Valuation Misstatement Penalty**

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“Concession Does Not Negate Gross Valuation Misstatement Penalties, Tax Court Holds”; March 14, 2013

Adopting the majority view of the circuit courts and departing from precedent, the Tax Court held March 14 that a taxpayer may not avoid a 40 percent gross valuation misstatement penalty under section 6662(h) by conceding a deduction or credit on grounds unrelated to value or basis of property.

In AHG Investments LLC v. Commissioner, 140 T.C. No. 7 (2013) (Doc 2013-6120), the IRS issued a final partnership administrative adjustment to Alan Ginsberg, a partner other than a tax matters partner (TMP) of AHG Investments LLC, and it disallowed $10 million in losses over two tax years. Ginsberg conceded on grounds other than valuation or basis that the FPAA adjustments were correct so as to avoid a 40 percent gross valuation misstatement penalty, and he filed a motion for partial summary judgment that the penalty does not apply as a matter of law.

Departing from precedent set in Todd v. Commissioner, 89 T.C. 912 (1987) (Doc 87-6738) and McCrary v. Commissioner, 92 T.C. 827 (1989) (Doc 89-2925), Judge Joseph Robert Goeke, writing on behalf of the court, said the IRS met its burden to persuade the Tax Court to overrule Todd and McCrary. In those cases the court concluded that if another ground besides valuation overstatement supports a deficiency, the deficiency cannot be attributable to a valuation overstatement, Goeke wrote. "However, the alternative view has been adopted by the majority of the U.S. Courts of Appeal," he wrote. (Prior analysis (Doc 2012-5967).)

"Today we depart from our precedent following the minority rule and side with the majority rule. By doing so we recognize that an underpayment of tax may be attributable to a valuation misstatement even when the Commissioner's determination of an underpayment of tax may also be sustained on a ground unrelated to basis or valuation," Goeke wrote.

Minority View

Both the Fifth and Ninth Circuit Courts of Appeal follow the Tax Court's prior precedent, which is the minority rule, that when the IRS asserts a ground unrelated to value or basis of property for totally disallowing a credit or deduction, and when the taxpayer concedes the credit or deduction on that ground, any underpayment resulting from the concession is not attributable to a gross valuation misstatement.

In the appeal of Todd v. Commissioner, 862 F.2d 540 (5th Cir. 1988), aff'g 89 T.C. 912 (1987) (Todd II) (Doc 89-616), the Fifth Circuit relied on the Tax Court's formula for finding that no portion of the underpayment was attributable to a valuation understatement, and pointed to the Joint Committee of Taxation's blue book explanation of section 6659, which proposed the same formula. That formula calculated an underpayment resulting from a valuation overstatement by comparing the taxpayer's actual tax liability with the actual tax liability reduced by taking into account the valuation overstatement, with the difference being the underpayment that is attributable to the valuation overstatement.

The Todd II court also adopted a view of conserving judicial resources, in that "Congress may not have wanted to burden the Tax Court with deciding difficult valuation issues where a case could be easily decided on other grounds." In Gainer v. Commissioner, 893 F.2d 225 (9th Cir. 1990) (Doc 90-325), the Ninth Circuit followed Todd II.

Majority View
Other circuit courts of appeal, adopting the majority rule, departed from that analysis, Goeke wrote, citing Fidelity International Currency Advisor A Fund LLC v. United States, 661 F.3d 667 (1st Cir. 2011) (Doc 2011-22298); Alpha I LP v. United States, 682 F.3d 1009 (Fed. Cir. 2012) (Doc 2012-12982); and Gustashaw v. Commissioner, 696 F.3d 1124 (11th Cir. 2012) (Doc 2012-20304). (Prior viewpoint (Doc 2013-2639).)

Goeke wrote that even the Ninth Circuit, adopter of the minority rule, had its doubts about the blue book formula. In Keller v. Commissioner, 556 F.3d 1056 (9th Cir. 2009) (Doc 2009-4282), the Ninth Circuit recognized that other courts of appeal had rejected the logic of Gainer, and that those circuits had adopted a more sensible method of resolving overvaluation cases. The court in Keller, however, was restrained from overruling Gainer, Goeke said.

So too was the Fifth Circuit constrained by stare decisis in Bemont Investors LLC v. United States, 679 F.3d 339 (5th Cir. 2012), despite the entire three-judge panel joining a special concurrence by Judge Edward C. Prado that said that the Todd II court misread the blue book, and that there was "near-unanimous" opposition to the Todd II decision.

**Which Circuit?**

Goeke said in the current case, it was unclear to which circuit the case would be appealed. At the time of the petition, Ginsberg, who was not the TMP, resided in Florida. The TMP, Helios Trading LLC, had an Illinois mailing address. But it was not established where AHG Investments’ principal place of business was or whether it had been dissolved at the time the petition was filed.

Noting that a principal place of business was not established by the parties at the time the petition was filed, that it wasn't clear whether AHG Investments had a principal place of business, and that the parties didn't stipulate a specific circuit for appeal, the Tax Court held that the appropriate venue for appeal would be the D.C. Circuit. "There is no evidence that an appeal would lie to the Court of Appeals for the Fifth or Ninth Circuit," Goeke wrote.

The D.C. Circuit has not held on the gross valuation misstatement penalty issue.

**Reaction**

Mark D. Allison of Caplin & Drysdale said that "insofar as the courts of appeal have been chipping away at the concession approach to mitigating the gross valuation penalty, the Tax Court decision may have been only a matter of time." Nonetheless, the court "punted on how it would have handled the issue in the Fifth and Ninth Circuits, and there will eventually need to be a day of reckoning with cases appealable there," Allison said.

Robert D. Probasco of Thompson & Knight LLP told Tax Analysts that the Tax Court's decision didn't surprise him "to a great deal," because "several courts have been taking an aggressive stance on the use of the gross valuation misstatement penalty." He added that the court's analysis also did not bring up any novel arguments.

And though several courts of appeal have addressed the issue, the split between the majority and minority views may be resolved by the Supreme Court, which on March 15 is set to discuss in conference the certiorari petitions in United States v. Gary Woods, No. 11-50487 (5th Cir. 2012) (petition (Doc 2013-960)) and Alpha I (petition (Doc 2013-958)), Probasco said.

"There's a very good likelihood that the Supreme Court will decide to hear this issue," Probasco said, adding however that the reverse is possible as well. The taxpayer in Woods argued in opposition to the government's petition that section 6662(i) now imposes a 40 percent penalty for undisclosed economic substance transactions, "which would apply to many of the cases in which the government has sought the gross valuation misstatement penalty in recent years," he said.

Anthony P. Daddino of Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP said that although the government views the 40 percent penalty as an issue worthy of Supreme Court review, "the reality is that Congress practically resolved the issue." The case law surrounding the 40 percent penalty has
predominantly involved transactions that were determined to lack economic substance, and as a result of the enactment of section 6662(i), the 40 percent penalty applies without exception to any undisclosed transaction that lacks economic substance, he said.

"The circuit split on the 40 percent penalty is on the verge of becoming moot, as the expiration of the three-year statute of limitations draws nearer for tax years preceding the effective date of the 2010 legislation," Daddino said.

Probasco said that the gross valuation misstatement penalty was probably not initially intended to apply as broadly as the government has been applying it recently. "There would have been a rationale for treating understatements attributable to gross valuation misstatements differently from other misstatements, but they would not necessarily have applied to every instance [in which] the IRS has attempted to do that," he said. Nonetheless, the statute is written the way it is and the government has been successful in convincing the courts it should apply broadly, he said, adding, "We'll have to wait to see how the Supreme Court rules if they do decide to take the case."

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