

Concession Does Not Negate Gross Valuation Misstatement Penalties

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Adopting the majority view of the circuit courts and departing from its own 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), 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* and *McCrary v. Commissioner*, 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: *Tax Notes*, Mar. 26, 2012, p. 1583.)

Goeke wrote that the IRS met its burden to persuade the Tax Court to overrule *Todd* and *McCrary*.

“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 circuits 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 *Todd*, the Fifth Circuit relied on the Tax Court’s formula for finding that no portion of the underpayment was attributable to a valuation understatement.

In the appeal of *Todd*, 862 F.2d 540 (5th Cir. 1988), *aff’d* 89 T.C. 912 (1987) (*Todd II*), 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 it 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 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), 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); *Alpha I LP v. United States*, 682 F.3d 1009 (Fed. Cir. 2012); and *Gustashaw v. Commissioner*, 696 F.3d 1124 (11th Cir. 2012). (Prior analysis: *Tax Notes*, Mar. 4, 2013, p. 1113.)

Goeke wrote that even the Ninth Circuit, adopter of the minority rule, had its doubts about the JCT blue book formula. In *Keller v. Commissioner*, 556 F.3d 1056 (9th Cir. 2009), 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 wasn't surprising 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.

'There's a very good likelihood that the Supreme Court will decide to hear this issue,' Probasco said.

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 will discuss in conference the certiorari petitions in *United States v. Gary Woods*, No. 11-50487 (5th Cir. 2012), and *Alpha I*, Probasco said.

"There's a very good likelihood that the Supreme Court will decide to hear this issue," Probasco said. 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 deserving 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 government has been successful in convincing the courts that the statute 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." ■