

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: CTM Branch 3, Section 1, Group 3
(Large Business and International)

from: Associate Area Counsel (Washington)
(Large Business & International)

subject: ("Taxpayer")
Tax years through
Analysis of Negligence Penalty and Reasonable Basis under I.R.C. § 6662 and
Reasonable Cause and Good Faith under I.R.C. § 6664

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This memo should not be cited as precedent.

ISSUES

1. Whether a penalty under section 6662 for negligence or disregard of rules or regulations should apply to the underpayment attributable to Taxpayer's reporting of its open-air parking structures as land improvements with 15-year depreciable lives, rather than as buildings with 39-year depreciable lives?
2. Whether Taxpayer had reasonable cause and acted in good faith under section 6664, which is a defense to an accuracy-related penalty?

CONCLUSIONS

1. There is a legally sufficient basis to apply a penalty for negligence or disregard of rules or regulations. The decision of whether to apply the penalty, however, rests with the IRS team manager.
2. Taxpayer has not demonstrated that it has met the reasonable cause and good faith exception to an accuracy-related penalty.

FACTS

Taxpayer is a _____ company headquartered in _____, and is a corporation organized in _____. Taxpayer is in the IRS's Coordinated Issue Case program (formerly the Controlled Examination Program). In _____, IRS Compliance began examining Taxpayer's Forms 1120, U.S. Corporate Income Tax Returns, for its _____ through _____ taxable years.

On _____, Taxpayer provided IRS Compliance with the following statement, provided under Revenue Procedure 94-69:

Parking Structures – Taxpayer treated Parking Structures (_____; _____^[1]) as land improvements, pursuant to guideline class 00.3, and depreciated such structures over a 15 year depreciable life. The IRS issued a Coordinated Issue Paper, subsequent to the period(s) that the Taxpayer had established its method for depreciating Parking Structures, advocating that such structures are more appropriately treated as buildings with a depreciable life of 39 years.

_____ Taxpayer believes, as of the time the applicable returns (Form 1120) were filed, it met the reasonable cause and good faith exception of IRC § 6664(c) and Reg. § 1.6664-4.

Previously Considered Open-Air Parking Structures

On _____, Taxpayer filed Form 3115 - Application for Change in Accounting Method, to reclassify the recovery period for depreciation purposes of its open-air parking structures from either 39 or 31.5 years to a 15-year recovery period. When the Form 3115 was filed, Taxpayer reported parking structures in service at _____ locations: _____, _____, and _____. Subsequently, Taxpayer's _____ through _____ tax years were examined. The IRS disallowed the 15-year recovery period on the parking structures and proposed a 39-year recovery period with adjustments. In _____, Taxpayer and IRS Appeals reached a basis of settlement regarding these structures,

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Taxpayer is a partner in _____ ("_____"), dba _____. _____ treated its open-air parking structure as a land improvement with a 15-year class life. In _____, IRS Appeals and _____ reached the same basis of settlement regarding _____'s parking structure as they did with Taxpayer's parking structures previously examined.³

Current Taxable Years under Examination

In _____, Taxpayer placed a new parking structure into service at its _____.

Taxpayer refers to this parking structure (and its other parking structures) as a "parking garage"⁴ and provides security for its parking structures.⁵ Each floor of the parking structure functions as a roof for the floor below, and the top floor has a cover. For depreciation purposes, Taxpayer classified the parking structure as a "land improvement" with a 15-year depreciable life.

IRS Compliance proposed to disallow Taxpayer's depreciation to the extent that it exceeds the amount allowable for property with a 39-year depreciable life, both for the parking structure at the _____, as well as proposed adjustments regarding the garages examined in the prior examination cycle.

Presentation

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(herein, "Taxpayer's Memo"), p. _____.

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⁵ At a minimum, the parking structure at Taxpayer's _____ the structure.

_____ has security cameras throughout

Taxpayer attended a presentation by () given at the tax section of the . The presentation addressed the depreciation period of an open-air parking structure. The presentation slides conclude that certain regulations (other than section 1.48-1(e)) “support the argument that parking structures belong in the land improvement category.”⁶

The slides state that the information “cannot be applied to a specific situation without appropriate professional advice,” and “use of words below such as ‘is,’ ‘should,’ ‘would,’ ‘will,’ etc. are not indicative of the likely opinion level that could be reached on each of the proposed transactions or issues.”⁷ The presentation was not based on Taxpayer’s specific facts.

Memorandum

The provided Taxpayer with a memorandum dated , which describes “tax planning strategies,”⁸ including a discussion of parking structures.

The memo is addressed to Taxpayer, but does not discuss any particular parking structure. The memo is a “summary discussion and is limited to the described facts” (although none of Taxpayer’s facts are provided nor analyzed).⁹ The memo is “not intended to be a formal opinion of tax consequences, and, thus, may not contain a full description of all the facts or a complete exposition and analysis of all relevant tax authorities” and, in fact, the memo omits many relevant tax authorities that provide contrary analysis.¹⁰ The memo states that it “is not binding on the IRS or the courts and should not be considered a representation, warranty, or guarantee that the IRS or the courts will concur with our conclusions.”¹¹

The memo suggests classifying parking structures as land improvements, concluding that a parking structure (generally) does not meet the definition of a “building.” suggestion is notwithstanding the discussion in the memo of the “function test” in section 1.48-1(e), which states that a structure is a building if a purpose is, for example, to provide parking.¹² The memo acknowledges that in most cases, a parking structure will meet the “function test since parking is one of the enumerated purposes in the regulation,” but then states that the appearance test is the “decisive factor” because a parking structure does not have walls or a roof, is open to the elements, and is not designed to provide shelter.¹³ The memo contains no discussion of the numerous cases that disregarded the appearance test over the function test, nor of the cases that

⁶ presentation at slide .

⁷ presentation at slide .

⁸ Memorandum dated , from the to Taxpayer (herein, “ Memo”), p. .

⁹ .

¹⁰ See .

¹¹ .

¹² .

¹³ .

have disregarded the argument that “walls” are necessary under the appearance test.

Cost Segregation Study

(“ ”) performed a cost segregation study for Taxpayer. The purpose of the study was to identify and segregate construction costs provided by Taxpayer to classify for depreciation purposes. The narrative of the study describes the scope of services and provides an overview of the legal provisions regarding depreciation. The narrative does not analyze any property or the classification of any property. Exhibit C of the cost segregation study contains the results of the study (by building), which lists a recovery period but no factual or legal analysis employed in reaching the conclusion.

According to its terms, the cost segregation study is “Other Written Advice as defined by Circular 230.” Accordingly, the “written advice was not intended or written to be used, and it cannot be used, for the purpose of avoiding tax penalties that may be imposed on the taxpayer.”¹⁴

Knowledge and Experience of Taxpayer

Taxpayer is a large company that has been operating for years.¹⁵ It operates wholly owned properties and has the interest in .¹⁶ Taxpayer is publicly traded on the .

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Taxpayer’s has been a since and has worked at Taxpayer since . Prior to working for Taxpayer, spent years as the of a company, and prior to that, spent almost years as a at .

Coordinated Issue Paper

Effective July 31, 2009, the then-IRS Large & Mid-size Business Division issued a coordinated issue paper (LMSB4-0709-029) regarding the applicable recovery period under section 168(a) for open-air parking structures. The coordinated issue paper

¹⁴ Cost Segregation Study .
¹⁵ .
¹⁶ .
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¹⁸ .

concludes that, based on Rev. Proc. 87-56 (Asset Class 00.3) and section 1.48-1(e), an open-air parking structure is a building and therefore has a 39-year depreciable life.¹⁹

Taxpayer's Memo Regarding Negligence Penalty

Taxpayer prepared a memo addressing the application of the negligence penalty under section 6662 to the parking structure issue.²⁰ On _____, IRS Compliance met with Taxpayer to discuss this issue.

Taxpayer made the following arguments as to why a penalty under section 6662(b)(1) should not be applied:

- (1) Taxpayer had a reasonable basis for its position, as explained in its protest of the issue in its prior tax examination, which was incorporated into the memo.²¹
- (2) Taxpayer had a reasonable basis because Appeals settled the issue in prior taxable years based on hazards of litigation.²²
- (3) Taxpayer did not disregard rules or regulations because it was aware of the regulation (Treas. Reg. § 1.48-1(e)) and “performed a substantial amount of diligence, as evidenced by the protest memorandums” in supporting the position taken on the return.²³
- (4) Taxpayer has reasonable cause for and acted in good faith, as provided in section 1.6664-4, with respect to its position because when Taxpayer filed its tax return, it had done extensive research in support of its position. This research was “supported by the issuance of a study provided by a public accounting firm with technical expertise in the subject matter.”²⁴
- (5) Taxpayer has reasonable cause for and acted in good faith with respect to its tax reporting because the LMSB Coordinated Issue Paper discussing the open-air parking structure was issued in 2009, almost _____ after Taxpayer filed its

¹⁹ On _____, the IRS circulated a draft coordinated issue paper for comments to the _____. Note also that the Cost Segregation Audit Technique Guide (Jan. 2005) includes field directives for the retail industry (issued 12/16/2004), the biotechnology industry (issued 11/28/2005), and the auto dealership industry (issued 2/25/2008), each of which categorize parking structures as 39-year property describing them as “Any structure or edifice the purpose of which is to provide parking space. Includes, for example, garages, parking ramps, or other parking structures.”

²⁰ Taxpayer's Memo.

²¹ Taxpayer's Memo _____. In the memo, Taxpayer states: “It is also relevant to note that unlike the *substantial authority* standard, reasonable basis exists whether or not the cited authorities have substantial weight compared to contrary authorities.” (Emphasis in original.) This statement ignores the language in the regulation that the reasonable basis standard requires “taking into account the relevance and persuasiveness of the authorities and subsequent developments.” Treas. Reg. § 1.6662-3(b)(3).

²² Taxpayer's Memo _____.

²³ Taxpayer's Memo _____.

²⁴ Taxpayer's Memo _____.

tax return.²⁵

- (6) Taxpayer has reasonable cause for and acted in good faith with respect to its tax reporting because it received a memorandum from _____ regarding this issue.²⁶

Law Regarding Issue Creating the Underpayment

The underlying issue that created the underpayment is whether an open-air parking structure is a building, which has a 39-year recovery period, or a land improvement, which has a 15-year recovery period.

For purposes of depreciation under section 168, the depreciation recovery period is generally determined by class life. Revenue Procedure 87-56, which sets forth class lives and recovery periods of property under section 168, describes the assets included as land improvements as:²⁷

Includes improvements directly to or added to land, whether such improvements are section 1245 property or section 1250 property, provided such improvements are depreciable. Examples of such assets might include sidewalks, roads, canals, waterways, drainage facilities, sewers (not including municipal sewers in Class 51), wharves, bridges, fences, landscaping, shrubbery, or radio and television transmitting towers. **Does not include** land improvements that are explicitly included in any other class, and **buildings and structural components as defined in section 1.48-1(e) of the regulations**. Excludes public utility initial clearing and grading land improvements as specified in Rev. Rul. 72-403, 1972-2 C.B. 102

Section 1.48-1(e) of the Treasury Regulations provides:

(e) Definition of building and structural components. (1) Generally, buildings and structural components thereof do not qualify as section 38 property. See, however, section 48(a)(1)(E) and (g), and § 1.48-11 (relating to investment credit for qualified rehabilitated building). **The term “building” generally means any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores.** Such term includes any such structure constructed by, or for, a lessee even if such structure must be removed, or ownership of such structure reverts to

²⁵ Taxpayer’s Memo _____. During the meeting on _____, Taxpayer’s _____ acknowledged that this argument was not significant.

²⁶ IRS meeting with Taxpayer’s _____ on _____.

²⁷ Rev. Proc. 87-56 (Asset Class 00.3) (Emphasis added).

the lessor, at the termination of the lease....

(Emphasis added.)

LAW

Negligence Penalty

If a taxpayer has an underpayment that is attributable to negligence or disregard of rules or regulations, a 20% penalty applies to the underpayment.²⁸ “Negligence” includes any failure to make a reasonable attempt to comply with the provisions of the Internal Revenue Code.²⁹ The regulations provide:³⁰

The term “negligence” includes any failure to make a reasonable attempt to comply with the provisions of the internal revenue laws or to exercise ordinary and reasonable care in the preparation of a tax return.

“Negligence” also includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly. A return position that has a reasonable basis as defined in paragraph (b)(3) is not attributable to negligence. Negligence is strongly indicated where—

- (i) A taxpayer fails to include on an income tax return an amount of income shown on an information return, as defined in section 6724(d)(1);
- (ii) A taxpayer fails to make a reasonable attempt to ascertain the correctness of a deduction, credit or exclusion on a return which would seem to a reasonable and prudent person to be “too good to be true” under the circumstances;
- (iii) A partner fails to comply with the requirements of section 6222, which require that a partner treat partnership items on its return in a manner that is consistent with the treatment of such items on the partnership return (or notify the Secretary of the inconsistency); or
- (iv) A shareholder fails to comply with requirements of section 6242, which requires that an S corporation shareholder treat subchapter S items on its return in a manner that is consistent with the treatment of such items on the corporation’s return (or notify the Secretary of the inconsistency).

“Disregard” includes any careless, reckless, or intentional disregard.³¹ The regulations

²⁸ Section 6662(b)(1); section 1.6662-3(a).

²⁹ Section 6662(c).

³⁰ Section 1.6662-3(b)(1).

³¹ Section 6662(c).

provide:³²

The term “disregard” includes any careless, reckless or intentional disregard of rules or regulations. The term “rules or regulations” includes the provisions of the Internal Revenue Code, temporary or final Treasury regulations issued under the Code, and revenue rulings or notices (other than notices of proposed rulemaking) issued by the Internal Revenue Service and published in the Internal Revenue Bulletin. A disregard of rules or regulations is “careless” if the taxpayer does not exercise reasonable diligence to determine the correctness of a return position that is contrary to the rule or regulation. A disregard is “reckless” if the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe. **A disregard is “intentional” if the taxpayer knows of the rule or regulation that is disregarded. Nevertheless, a taxpayer who takes a position** (other than with respect to a reportable transaction, as defined in § 1.6011-4(b) or § 1.6011-4T(b), as applicable) **contrary to a revenue ruling or notice has not disregarded the ruling or notice if the contrary position has a realistic possibility of being sustained on the merits.**

Reasonable Basis

“Reasonable basis” is defined in the regulations as:³³

Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in § 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in § 1.6662-4(d)(2). (See § 1.6662-4(d)(3)(ii) for rules with respect to relevance, persuasiveness, subsequent developments, and the use of a well-reasoned construction of an applicable statutory provision for purposes of the substantial understatement penalty.) In addition, the reasonable cause and good faith exception in § 1.6664-4 may provide relief from the penalty for negligence or disregard of rules or regulations, even if a return position does not satisfy the reasonable basis standard.

The authorities upon which a position may be reasonably based are in section 1.6662-

³² Section 1.6662-3(b)(2) (emphasis added).

³³ Section 1.6662-3(b)(3).

4(d)(3)(iii), which provides:

Except in cases described in paragraph (d)(3)(iv) of this section concerning written determinations, only the following are authority for purposes of determining whether there is substantial authority for the tax treatment of an item: applicable provisions of the Internal Revenue Code and other statutory provisions; proposed, temporary and final regulations construing such statutes; revenue rulings and revenue procedures; tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties; court cases; congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill's managers; General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book); private letter rulings and technical advice memoranda issued after October 31, 1976; actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin); Internal Revenue Service information or press releases; and notices, announcements, and other administrative pronouncements published by the Service in the Internal Revenue Bulletin. Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professionals are not authority. The authorities underlying such expressions of opinion where applicable to the facts of a particular case, however, may give rise to substantial authority for the tax treatment of an item. Notwithstanding the preceding list of authorities, an authority does not continue to be an authority to the extent it is overruled or modified, implicitly or explicitly, by a body with the power to overrule or modify the earlier authority. In the case of court decisions, for example, a district court opinion on an issue is not an authority if overruled or reversed by the United States Court of Appeals for such district. However, a Tax Court opinion is not considered to be overruled or modified by a court of appeals to which a taxpayer does not have a right of appeal, unless the Tax Court adopts the holding of the court of appeals. Similarly, a private letter ruling is not authority if revoked or if inconsistent with a subsequent proposed regulation, revenue ruling or other administrative pronouncement published in the Internal Revenue Bulletin.

Reasonable Cause and Good Faith

The accuracy-related penalty under section 6662 does not apply to the extent that a taxpayer has reasonable cause for the underpayment and the taxpayer acted in good faith with respect to such portion.³⁴ The regulations explain the analysis to be conducted to determine if a taxpayer acted with reasonable cause and in good faith as

³⁴ Section 6664(c)(1); sections 1.6662-3(a) and 1.6664-4(a).

follows.³⁵

Facts and circumstances taken into account – (1) In general. The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. (See paragraph (e) of this section for certain rules relating to a substantial understatement penalty attributable to tax shelter items of corporations.) Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of the all the facts and circumstances, including the experience, knowledge, and education of the taxpayer. An isolated computational error or transcriptional error generally is not inconsistent with reasonable cause and good faith. Reliance on an information return or on the advice of a professional tax advisor or an appraiser does not necessarily demonstrate reasonable cause and good faith. Similarly, reasonable cause and good faith is not necessarily indicated by reliance on facts that, unknown to the taxpayer, are incorrect. Reliance on an information return, professional advice, or other facts, however, constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith. (See paragraph (c) of this section for certain rules relating to reliance on the advice of others.)

The regulation regarding reliance on opinion or advice states:³⁶

Reliance on opinion or advice – (1) Facts and circumstances; minimum requirements. All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor) as to the treatment of the taxpayer (or any entity, plan, or arrangement) under Federal tax law. For example, the taxpayer's education, sophistication and business experience will be relevant in determining whether the taxpayer's reliance on tax advice was reasonable and made in good faith. In no event will a taxpayer be considered to have reasonably relied in good faith on advice (including an opinion) unless the requirements of this paragraph (c)(1) are satisfied. The fact that these requirements are satisfied, however, will not necessarily establish that the taxpayer reasonably relied on the advice (including the opinion of a tax advisor) in good faith. For example, reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.

³⁵ Section 1.6664-4(b)(1).

³⁶ Section 1.6664-4(c).

(i) All facts and circumstances considered. The advice must be based upon all pertinent facts and circumstances and the law as it relates to those facts and circumstances. For example, the advice must take into account the taxpayer's purposes (and the relative weight of such purposes) for entering into a transaction and for structuring a transaction in a particular manner. In addition, the requirements of this paragraph (c)(1) are not satisfied if the taxpayer fails to disclose a fact that it knows, or reasonably should know, to be relevant to the proper tax treatment of an item.

(ii) No unreasonable assumptions. The advice must not be based on unreasonable factual or legal assumptions (including assumptions as to future events) and must not unreasonably rely on the representations, statements, findings, or agreements of the taxpayer or any other person. For example, the advice must not be based upon a representation or assumption which the taxpayer knows, or has reason to know, is unlikely to be true, such as an inaccurate representation or assumption as to the taxpayer's purposes for entering into a transaction or for structuring a transaction in a particular manner.

(iii) Reliance on the invalidity of a regulation. A taxpayer may not rely on an opinion or advice that a regulation is invalid to establish that the taxpayer acted with reasonable cause and good faith unless the taxpayer adequately disclosed, in accordance with § 1.6662-3(c)(2), the position that the regulation in question is invalid.

(2) Advice defined. Advice is any communication, including the opinion of a professional tax advisor, setting forth the analysis or conclusion of a person, other than the taxpayer, provided to (or for the benefit of) the taxpayer and on which the taxpayer relies, directly or indirectly, with respect to the imposition of the section 6662 accuracy-related penalty. Advice does not have to be in any particular form.

The initial determination of whether a penalty should be imposed must be approved by the immediate supervisor (e.g., the team manager) of the person proposing the penalty.³⁷

ANALYSIS

Preliminary Comments Regarding Taxpayer's Protest (Prior Examination)
Taxpayer makes the underlying issue more complicated than is required or

³⁷ IRM 20.1.1.2.3 (11-25-2011).

appropriate.³⁸ IRS Compliance and Taxpayer agree that Rev. Proc. 87-56 sets forth the class life and recovery period of land improvements, which excludes buildings, as defined in section 1.48-1(e) of the regulations.³⁹ Thus, the issue requires determining whether the parking structures are buildings under section 1.48-1(e).

To have a reasonable basis, Taxpayer's position must be "reasonably based" on the applicable authorities.⁴⁰ The authorities must be relevant and must not ignore contrary authorities.⁴¹ Taxpayer advanced numerous arguments as to why it should prevail on the underlying issue and, therefore, why it has a reasonable basis. As explained herein, Taxpayer's arguments are not reasonably based on the applicable law and Taxpayer is ignoring the language in section 1.48-1(e) and in relevant case law. As a result, at best, Taxpayer's return position is merely arguable or merely a colorable claim. Therefore, Taxpayer does not have a reasonable basis for its return position.

Argument 1: Reasonable Basis based on Protest Arguments

Taxpayer raised several arguments in the protest of its prior IRS examination (

) to support its position that a parking garage is a land improvement which has a 15-year life, rather than a building, which has a 39-year life, for purposes of depreciation. Taxpayer's arguments are (or appear to be):

- (A) Treasury Regulation section 1.48-1(e) is invalid because it added the words "parking" and "garage," where as the legislative history to the investment tax credit did not include those words.⁴²
- (B) The parking structures do not appear as buildings. They do not have floor-to-ceiling walls, a conventional roof, and they do not share supporting structural elements.⁴³

³⁸ Taxpayer's Memo. pp. ("The issue of whether the Parking Deck constitutes a 'land improvement' or 'nonresidential real property' requires an analysis of various statutes, regulations, administrative pronouncements, and judicial guidance.) (citing I.R.C. §§ 48, 167, 168, 1245, and 1250; Treas. Reg. §§ 1.48-1, 1.263A-8, 1.1245-3, and 1.1250-1; Rev. Proc. 87-56; IRS Cost Segregation Audit Technique Guide; and IRS Coordinated Issue Paper on Open-Air Parking Structures).

³⁹ Taxpayer's Memo.

⁴⁰ Treas. Reg. § 1.6662-3(b)(3).

⁴¹ See Treas. Reg. § 1.6662-3(b)(3) ("If a return position is reasonably based on one or more of the authorities set forth in § 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard"); Smith v. Commissioner, T.C. Memo. 2006-51 (rejecting taxpayers' claim of reasonable basis to avoid a negligence penalty when taxpayers ignored contrary authority).

⁴² Taxpayer's Memo. pp.

⁴³ Taxpayer's Memo. pp.

- (C) The parking structures do not function as buildings because they provide only incidental working space, they offer only minimal shelter from the elements, they offer only limited protection from vandalism and theft, and their primary purpose is storage of vehicles.⁴⁴
- (D) A paved surface parking area is a land improvement under section 1.48-1(c); its parking structures are parking lots stacked one on top of another and, therefore, are land improvements.⁴⁵
- (E) Courts have rejected the IRS's literal interpretation of section 1.48-1(e)(1), which lists "parking" as a function and "garage" as an example of a building.⁴⁶
- (F) A stand-alone parking structure is not a "garage" and is therefore not a building under section 1.48-1(e)(1).⁴⁷

Protest Argument A – Validity of Section 1.48-1(e)

Taxpayer states that section 1.48-1(e) is broader than the legislative history regarding the investment credit.⁴⁸ Taxpayer appears to infer that the regulation, which is a legislative regulation, is invalid. This argument has previously been rejected.⁴⁹ Accordingly, Taxpayer's argument is improper and does not provide Taxpayer with a reasonable basis.

Protest Argument B – Appearance Test

Taxpayer states that, other than underground levels, the parking structures do not contain floor-to-ceiling walls, they do not contain conventional roofs, they offer minimal shelter from the elements, and much of the parking decks were freely accessible to people and animals.⁵⁰ Therefore, Taxpayer concludes that "facilities such as the parking decks differ in appearance from buildings in many important ways."⁵¹

Taxpayer's argument addresses the so-called "appearance test" in section 1.48-1(e), which contains both the appearance test and a "function" test. Even assuming

⁴⁴ Taxpayer's Memo. pp. .

⁴⁵ Taxpayer's Memo. p. .

⁴⁶ Taxpayer's Memo. pp. .

⁴⁷ Taxpayer's Memo. pp. .

⁴⁸ Taxpayer's Memo. pp. .

⁴⁹ Consolidated Freightways, Inc. v. U.S., 620 F.2d 862, 872 (Ct. Cl. 1980); Yellow Freight Systems, Inc. v. Commissioner, 538 F.2d 790, 795-796 (8th Cir. 1976) ("The regulation is within the granted power, issued pursuant to a proper procedure, and reasonable. It is, therefore, a legislative regulation which is as binding on this court as the statute itself.")

⁵⁰ Taxpayer's Memo. .

⁵¹ Taxpayer's Memo. .

arguing that Taxpayer is correct that the parking structures are not buildings under the appearance test (which Taxpayer is not), “courts uniformly accord primary emphasis on the function test” in section 1.48-1(e)(1), a point that Taxpayer repeatedly acknowledges in its protest.⁵² The relevant courts have either minimized or done away with the appearance test, applying only the functional test.⁵³ By elevating the appearance test over the functional test, Taxpayer ignores the reasonable-basis requirement of taking into account the relevance and persuasiveness of authorities and subsequent developments.⁵⁴

Moreover, Taxpayer’s conclusion that the parking structures are not buildings under the appearance test also lacks a reasonable basis. Taxpayer repeatedly emphasized that the parking structures do not contain floor-to-ceiling walls. The applicable authorities are clear that a structure is not required to have walls to enclose its space. Taxpayer is misreading the plain language of section 1.48-1(e)(1), which states: “The term ‘building’ generally means any structure or edifice enclosing a space within its walls, and usually covered by a roof....” (Emphasis added.) Use of the word “generally” means that a structure or edifice considered a building is normally, but not necessarily, a structure or edifice that encloses a space within its walls. This common-sense reading of the regulation has been employed by the courts.⁵⁵ Similarly, even accepting that a parking

⁵² Taxpayer’s Memo. ; see also Taxpayer’s Memo. (“It must also be noted that the courts generally place primary emphasis on the function test.”); (categorizing cases decided by or appealable to the Court of Appeals for the 9th Circuit, none of which placed reliance on the appearance test and seven of which that placed reliance on the function test); and (“primary reliance has been placed upon the function test.”).

⁵³ See, e.g., Consolidated Freightways, Inc. v. Commissioner, 708 F.2d 1385, 1987 (9th Cir. 1983) (rejecting the taxpayer’s argument that the Tax Court erred in failing to apply the appearance test); Thirup v. Commissioner, 508 F.2d 915, 919 (9th Cir. 1974) (stating we “thoroughly agree ... [with the] recent authorities ... [who have] abandon[ed] the appearance test, and we employed the functional test and hold that greenhouses are not buildings”) (alterations in original); Consolidated Freightways, Inc. v. U.S., 620 F.2d 862, 870 (Ct. Cl. 1980) (“Because of this imprecision of the appearance test, we place the major emphasis on a ‘functional’ test.”); Brown-Forman Distillers Corp. v. U.S., 499 F.2d 1263, 1271 (Ct. Cl. 1974) (“the real inquiry is whether [the structures] are functioning or being used as buildings”).

⁵⁴ See Treas. Reg. § 1.6662-3(b)(3); Smith v. Commissioner, T.C. Memo. 2006-51 (taxpayers’ reliance on an old statute and regulation was unreasonable because taxpayers ignored two court opinions and admonitions from the IRS).

⁵⁵ See, e.g., Consolidated Freightways, Inc. v. Commissioner, 708 F.2d 1385, 1388 (9th Cir. 1983) (“For purposes of the investment tax credit, a structure without permanent walls may constitute a building”) (holding that truck loading docks without permanent walls were buildings); A.C. Monk & Co., Inc. v. U.S., 686 F.2d 1058, 1063 (4th Cir. 1982) (determining that although a dock’s workplace was not enclosed by full walls on all sides, it was an obvious extension of the factory structure as much as a porch is an extension of a house and was therefore a building); Yellow Freight System, Inc. v. U.S., 538 F.2d 790, 796 & n.9 (8th Cir. 1976) (“we do not regard as controlling the fact that the docks have no discernable walls. . .” Treas. Reg. § 1.48-1(e)(1) “furnishes only a general description which does not attempt to define in exact terms the outer limits of what may be properly categorized as a building.”) (holding that docks not enclosed within walls and that have no doors were buildings under Treas. Reg. § 1.48-1(e)(1)); Consolidated Freightways, Inc. v. U.S., 620 F.2d 862, n.17 (Ct. Cl. 1980) (rejecting the taxpayer’s assertion that “normal” walls are required for building classification because “this language is found in neither the regulations nor the legislative history cited to us”); Leshner v. Commissioner, 73 T.C. 340, 368 (1979) (holding that a general purpose livestock barn that had only 3 walls was a building within the

structure is without a roof (which IRS Compliance rejects because the next parking level is a roof for the preceding level and the _____), the regulation says “usually” covered by a roof, not necessarily covered by a roof. Again, by ignoring these authorities, Taxpayer has not reasonably based its position on the applicable authorities and developments.⁵⁶ Therefore, this argument does not provide Taxpayer with a reasonable basis.

Protest Argument C – Function Test

Taxpayer states that the parking structures do not function as buildings because they provide only incidental working space, they offer only minimal shelter from the elements, they offer only limited protection from vandalism, and their primary purpose is storage of vehicles.⁵⁷ The function test in section 1.48-1(e) provides that a “building” generally means a structure “the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores.” (Emphasis added.) Use of the word “or” means that the items in the series are disjunctive:⁵⁸ if the purpose is any one of the functions listed, the functional test is satisfied. The purpose of the parking structures is – as their name suggests – to provide parking.

In an attempt to avoid using the word “parking,” Taxpayer stated that the purpose of the parking structures is to provide “storage of vehicles” (rather than parking). IRS Compliance disputes Taxpayer’s strained interpretation of the activity. Notwithstanding, even if the purpose of the parking structures were to store vehicles, the function test in section 1.48-1(e)(1) would nonetheless require concluding that the structures are buildings. Section 1.48-1(e)(1) provides examples of buildings, including “warehouses” and “garages.” A parking structure that holds vehicles for storage would also be considered a building under the regulation.⁵⁹ Taxpayer has not reasonably based its position on the applicable authorities and developments.⁶⁰ Therefore, this argument does not provide Taxpayer with a reasonable basis.

meaning of Treas. Reg. § 1.48-1(e)(1)); see also Rev. Proc. 79-406, 1972-2 C.B. 18 (self-service car wash structure built of cinder blocks on a cement foundation, despite containing four stalls that are opened at each end, is a building).

⁵⁶ See Treas. Reg. § 1.6662-3(b)(3).

⁵⁷ Taxpayer’s Memo. pp. _____.

⁵⁸ C.f. Myles Lorentz, Inc. v. Commissioner, 138 T.C. 40, 45 (2012) (“Both by definition and by example the regulation distinguishes the two (it uses the disjunctive ‘or’), and does not use a phrase such as ‘or a combination thereof.’”); Beech Trucking Co., Inc. v. Commissioner, 118 T.C. 428, n.12 (2002) (interpreting the connector “or” in a series to mean the test is disjunctive, meaning only one item need be satisfied); Santana v. Commissioner, T.C. Memo. 2012-49 (same).

⁵⁹ See McManus v. U.S., 863 F.2d 491, 496 (7th Cir. 1988) (holding that a hanger structure that held airplanes “functions as a warehouse or garage ... and falls within the regulation’s explicit examples and general definition of a building.”).

⁶⁰ See Treas. Reg. § 1.6662-3(b)(3).

Protest Argument D – Stacked Surface Lots

Taxpayer argues that its parking structures are a series of parking lots stacked one on top of another.⁶¹ Because a paved, surface parking lot is a land improvement for purposes of depreciation, Taxpayer maintains that its parking structures should also be considered land improvements. Taxpayer's argument is patently improper – a surface parking lot is different from a parking garage.⁶² The parking structures are garages, the purpose of which is to provide parking. Under section 1.48-1(e), the parking structure is a building. For a taxpayer to have a reasonable basis, the position must be not frivolous and not patently improper.⁶³ Taxpayer's argument is both frivolous and patently improper, reminding us of Abe Lincoln's riddle, "How many legs does a dog have if you call a tail a leg? The answer is four, because calling a tail a leg does not make it one."⁶⁴ Like the tail, the parking structures should be recognized for what they are, not what Taxpayer professes them to be. This argument does not provide a reasonable basis for Taxpayer.

*Protest Argument E – Rejection of Literal Language of Section 1.48-1(e)(1)*⁶⁵

Taxpayer argues that the literal language of section 1.48-1(e) – which states that a structure is a building if its purpose is parking and, for example, if it is a garage – should be ignored.⁶⁶ In support of its argument, Taxpayer states that in cases dealing with refrigerated storage facilities, some courts rejected a literal interpretation of the regulation. In those cases, the courts held that the storage facilities were not buildings, notwithstanding that they could be considered warehouses. Taxpayer acknowledges that the Court of Appeals for the Eighth Circuit has taken a different approach (*i.e.*, interpreting the regulation literally), but states that "the Court of Appeals for the Ninth Circuit, the circuit to which [Taxpayer's] appeal would lie, is one of those 'other circuits' that follow the Tax Court's (non-literal) interpretation of the regulation."⁶⁷

⁶¹ Taxpayer's Memo. .

⁶² Babin v. Commissioner, T.C. Memo. 1992-673 ("Both buildings ... shared two and three level parking garages, as well as a surface parking lot").

⁶³ Treas. Reg. § 1.6662-3(b)(3).

⁶⁴ BB&T Corp. v. U.S., 523 F.3d 461, 477 (4th Cir. 2008).

⁶⁵ This discussion is equally applicable to the argument numbered in Taxpayer's Memo (beginning at the bottom of of Taxpayer's memo). Therefore, we did not include a separate discussion refuting argument . We note, however, that Taxpayer states in its argument 3: "There are several cases in which the structures which acted in the capacity of a storage facility were determined to be a building based on the level of human activity within the structure." Taxpayer then cites as one of those cases Tamura v. U.S., 734 F.2d 470 (9th Cir. 1984). Taxpayer is incorrect – in Tamura v. U.S., the Court of Appeals for the Ninth Circuit did not consider human activity at all in its conclusion that an onion-storage shed was a building.

⁶⁶ Taxpayer's Memo. .

⁶⁷ Taxpayer's Memo. .

First, the cases dealing with refrigerated-storage facilities are factually distinguishable from Taxpayer's case dealing with parking structures. Second, Taxpayer is incorrect – the Court of Appeals for the Eighth Circuit follows the approach originally enunciated by the Court of Appeals for the Ninth Circuit.

In analyzing whether a refrigerated-storage structure was a building, the Tax Court, in some of those cases, considered whether the purpose of the structure is to provide working space for employees that is more than merely incidental to the main purpose of the structure.⁶⁸ Upon review of a refrigerated storage case, the Court of Appeals for the Eighth Circuit, in L&B Corp. v. Commissioner, criticized the Tax Courts' interpretation of the regulation, stating.⁶⁹

Second, the Tax Court applied an unduly restrictive version of the function test in this case. Following Munford, Inc. v. Commissioner, 87 T.C. 463 (1986), aff'd 849 F.2d 1398 (11th Cir. 1988), the Tax Court held that the structures in the present case are not "buildings" because they do not primarily provide working space for humans. Tax Court Opinion, at 25. We believe this holding ignores the full definition in Treas. Reg. § 1.48-1(e)(1), which specifically includes structures that provide shelter, housing, working space, office space, parking, display areas, or sales space within the definition of "building." Nothing, either in the Code or in the Regulations, implies that this space must be primarily occupied by humans to qualify as a building.

The Court of Appeals for the Eighth Circuit explained the genesis of the Tax Court's incorrect interpretation.⁷⁰

The Tax Court's departure from the original intent of Congress stems from its interpretation of Yellow Freight System, Inc. v. U.S., 538 F.2d 790 (8th Cir. 1976). In Yellow Freight, this Court held that docks and inspection lanes constructed by a freight carrier constituted "buildings" within the meaning of section 48(a)(1)(B). The loading docks and inspection lanes were permanent structures used to expedite freight and to inspect the long-haul vehicles. In a footnote to its discussion of the "function" test, this Court stated:

We consider the amount of human activity which occurs within the structure an important consideration under § 48(a)(1)(B) since "buildings," according to Treas. Reg.

⁶⁸ See Munford, Inc. v. Commissioner, 87 T.C. 463 (1986), aff'd 849 F.2d 1398 (11th Cir. 1988); Merchants Refrigeration Company of California v. Commissioner, 60 T.C. 856 (1973); L&B Corp. v. Commissioner, 88 T.C. 744 (1987).

⁶⁹ L&B Corp. v. Commissioner, 862 F.2d 667, 671-672 (8th Cir. 1988).

⁷⁰ L&B Corp. v. Commissioner, 862 F.2d at n.6.

§ 1.48-1(e), typically provide work space for such human activity. The quantum of employee activity is, in our opinion, critical in determining whether the function of a given structure is principally, or only incidentally, to provide work space.

Yellow Freight, 538 F.2d at 797 n.11 (citations omitted).

Footnote 11, discussing the amount of human activity carried on, was in response to a case in which the Ninth Circuit held that the nature of human activity was relevant to the definition of “building,” but the amount of human activity was not. See Thirup v. Commissioner, 508 F.2d 915, 919 (9th Cir. 1974), rev’g 59 T.C. 122 (1972).

Although this footnote may lend some support for the Tax Court’s application of the function test, the holding of Yellow Freight does not. In Yellow Freight, this Court held that loading docks and inspection lanes constituted “buildings” because the property provided “shelter and work space so that the men and equipment can perform their functions.” Id. at 796. This Court did not hold that only structures providing working space for humans constitute “buildings.”

The issue in Thirup v. Commissioner was whether greenhouses were “buildings” for purposes of the investment tax credit.⁷¹ When applying the functional test, the Court of Appeals for the Ninth Circuit did not interpret section 1.48-1(e) as requiring the space be primarily occupied by humans before it would be classified as a building. To the contrary, the Court of Appeals for the Ninth Circuit found “the distinction based on human activity unpersuasive” and employee activity was considered only to determine the principle function of the structure. Specifically, the court stated:⁷²

The functional test carves out those types of general purpose buildings, such as “apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores,” Treas. Reg. 1.48-1(e)(1), that we think Congress intended to exclude from the investment tax credit. But the test preserves for the credit those specialized structures whose utility is principally and primarily a significantly contributive factor in the actual manufacturing or production of the product itself.

Applying a functional test, the Tax Court found in Thirup and in Sunnyside Nurseries, that the amount of employee activity taking place inside the greenhouses indicated that the greenhouses provided working space, one

⁷¹ Thirup v. Commissioner, 508 F.2d 915, 917 (9th Cir. 1974).

⁷² Thirup v. Commissioner, 508 F.2d at 919-920.

of the enumerated functions of a “building.” In Brown-Forman Distillers, supra, and Satrum, supra, the courts distinguished Sunnyside Nurseries on the ground that Sunnyside’s employees spent more time inside the greenhouses than, respectively, Brown-Forman’s employees spent inside the whiskey warehouses or Satrum’s workers spent in the chicken coops.

We find the distinction based on the amount of human activity unpersuasive. The proper inquiry, which goes to the nature of the employee activity inside the structures, is “whether the structures provide working space for employees that is more than merely incidental to the principal function or use of the structure.” Brown-Forman Distillers Corp. v. U.S., 499 F.2d 1263, 1271 (Ct. Cl. 1974). See Robert E. Catron, 50 T.C. 306, 316 (1968) (reviewed by the full Court).

In Satrum, supra, employees worked in aisles between the rows of chicken cages inside the structures to collect eggs, feed chickens, and remove droppings. Workers also spent long periods of time inside the structures removing thousands of chickens that were to be sent to market and replacing those chickens with younger birds. The Tax Court characterized these activities as “merely supporting of, and ancillary to,” the purpose of the chickens and expressly found the structures did not provide working space. 62 T.C. at 417. In our judgment, the activities of the Thirups’ greenhouses employees were, without a doubt, of the same supportive and ancillary nature as the activities of the workers in Satrum. That flowers may require more human care than chickens is not a sufficient reason for deciding that greenhouses are “buildings” while chicken coops are not.

We conclude that under the functional test, the Thirups’ greenhouses do not function as “buildings,” as that term is employed in section 48. The greenhouses supply the controlled environment that is essential to the commercial production of more and finer cut flowers, a function neither enumerated in Treasury Regulation 1.48-1(e)(1) nor sufficiently similar to the enumerated functions to be within their scope.

Similarly, in another case, Consolidated Freightways, Inc. v. Commissioner, when applying the function test in section 1.48-1(e), the Court of Appeals for the Ninth Circuit, said: “If it functions as a building because, for example, it furnishes working space to its employees, it is then necessary to consider the relationship between the ‘nature’ of the employee activities inside the structure and the structure’s primary function....”⁷³ (Emphasis added.) Thus, from this language, the Court of Appeals for the Ninth Circuit states that the function of employee work space is not necessary for classification as a building. In that opinion, the 9th Circuit court further stated, “It is true that the Thirup

⁷³ Consolidated Freightways, Inc. v. Commissioner, 708 F.2d 1385, 1388 (9th Cir. 1983).

court [a decision by the 9th Circuit] found ‘unpersuasive’ the distinction between buildings and other structures based on the amount of human activity in the same structures.”⁷⁴ These cases further support that Taxpayer incorrectly stated that the 9th Circuit applies a non-literal interpretation of section 1.48-1(e).

In a third case decided by the Court of Appeals for the Ninth Circuit, Tamura v. U.S.,⁷⁵ the Court of Appeals for the Ninth Circuit did not consider human activity at all in its conclusion that an onion-storage shed was a building. The 9th Circuit concluded that the onion shed was a building because it “functions more like a barn, warehouse, or garage (‘building[s]’) than it does as a storage tank, silo, or coke oven (not ‘building[s]’). See Treas. Reg. § 1.48-1(e)(1). No matter how you look at it, inside out, upside down, from the east or west, north or south, the structure, even in common parlance, is a building.”⁷⁶

Taxpayer cited no (accurate) authority for its proposition that the Court of Appeals for the Ninth Circuit applies a non-literal interpretation of section 1.48-1(e). As discussed herein, the case law reflects that the authority states the contrary: the Court of Appeals for the Ninth Circuit interprets the language in section 1.48-1(e) literally. Misreading cases does not provide Taxpayer with reasonable basis.⁷⁷

Protest Argument F – Parking Structure is Not a Garage

Taxpayer acknowledges that an example of a building in section 1.48-1(e) includes a garage, but states that “garage” is not defined in the regulation or in case law because it “has a commonly accepted definition.”⁷⁸ That definition, Taxpayer states, “is a fully enclosed structure that protects vehicles from the elements, theft, and vandalism.”⁷⁹

⁷⁴ Consolidated Freightways, Inc. v. Commissioner, 708 F.2d at 1388.

⁷⁵ Tamura v. U.S., 734 F.2d 470 (9th Cir. 1984).

⁷⁶ Tamura v. U.S., 734 F.2d at 472-473. Moreover, we note that in Illinois Cereal Mills, Inc. v. Commissioner, T.C. Memo. 1983-469, the Tax Court said: “In applying the functional test, an important but not determinative factor has been the human activity within the structure. Consolidated Freightways, Inc. v. Commissioner, 708 F.2d 1385 (9th Cir. 1983), aff’g on this issue 74 T.C. 768 (1980); Thirup v. Commissioner, [508 F.2d 915 (9th Cir. 1974), rev’g 59 T.C. 122 (1972)]; Valmont Indus., Inc. v. Commissioner, 73 T.C. 1059 (1980).” (Note the Tax Court’s citation to two cases decided by the Court of Appeals for the Ninth Circuit.) The Tax Court continued: “For example, even when there is substantial human activity within the structure (greenhouse), the structure may not be a building if the structure itself functions as something other than a building. Thirup v. Commissioner, supra.” (Again, citing a case decided by the Court of Appeals for the Ninth Circuit.)

⁷⁷ Treas. Reg. § 1.6662-3(b)(3) (return position must be reasonably based on authority); c.f. Richardson v. Commissioner, 125 F.3d 551, 558 (7th Cir. 1997) (holding that no reasonable cause applied to taxpayer – “an educated person who understands business matters” – who misread a state-court opinion regarding alimony payments), aff’g T.C. Memo. 1995-554; Campbell v. Commissioner, 134 T.C. 20, 33-34 (2010) (holding that no reasonable cause existed when the taxpayer relied on a citation to a footnote in a case that reached a holding adverse to its position, finding the taxpayer’s position neither persuasive nor reasonable, especially given the taxpayer’s experience, knowledge, and education).

⁷⁸ Taxpayer’s Memo .

⁷⁹ Taxpayer’s Memo .

Noticeably absent from that definition, however, is a citation to its source. Contrary to Taxpayer's definition, Merriam-Webster defines a garage simply as "a shelter or repair shop for automotive vehicles."⁸⁰

Taxpayer concludes that its parking structures provide only limited protection from the elements and, because they provide unrestricted access, they provide no protection from thieves and vandals. Therefore, Taxpayer concludes, the parking structures addressed in the underlying issue are not garages.⁸¹ Taxpayer's argument is without merit.

First, Taxpayer refers to its parking structures as garages.⁸² Second, to a varying extent, Taxpayer's parking structures provide protection from the elements. Third, Taxpayer's parking structures provide security.

As support for Taxpayer's conclusion, Taxpayer cites McManus v. U.S., 863 F.2d 491 (7th Cir. 1988). This case regards a hangar structure for airplanes and concludes that it is a building. In that case, the court stated "the hangar structure protects airplanes from nature and unwanted visitors. It functions as a warehouse or garage...."⁸³ First, the McManus opinion does not conclude that protection from nature and unwanted elements is a necessary requirement to be a garage. Even if it had, however, as mentioned previously, Taxpayer's parking structures meet these requirements. Therefore, this argument is without merit and does not provide Taxpayer with reasonable basis.

Argument 2: Reasonable Basis based on Prior Appeals Settlement

Taxpayer states that it has reasonable basis because:⁸⁴

the Appeals team leader affirmatively stated the Company's [Taxpayer's] position was deserving of merit and settled (including the issuance of a closing agreement) [regarding] the exact same issue in a previous exam cycle, based on hazards of litigation and in spite of the existence of the open air parking structure CIP, further supports the technical merits of our analysis and validates the position as having reasonable basis.

⁸⁰ <http://www.merriam-webster.com/dictionary/garage>.

⁸¹ Taxpayer's Memo .

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⁸³ McManus v. U.S., 863 F.2d 491, 496 (7th Cir. 1988).

⁸⁴ Taxpayer's Memo . During the meeting on , clarified that, because Taxpayer convinced IRS Appeals to concede % of the issue, Taxpayer equates that to reasonable basis. This clarification adds no new dimension to the analysis.

Whether a taxpayer has a reasonable basis under section 1.6662-3(b)(3) is determined from the list of authorities in section 1.6662-4(d)(3)(iii). Opinions rendered by tax professionals are explicitly excluded from this list. Therefore, the opinion of an IRS Appeal's officer of the merits of the issue is not "authority" upon which reasonable basis can be determined and does not provide Taxpayer with reasonable basis.⁸⁵

Argument 3: No Disregard of Regulation Because Researched Position Taken on Return

Taxpayer states that it did not disregard the rules or regulations because it "was clearly aware of the regulation, did not disregard such regulation, and performed a substantial amount of due diligence, as evidenced by the protest memorandums attached below, in supporting the position taken on the return."⁸⁶

"Disregard" includes any careless, reckless or intentional disregard of rules or regulations.⁸⁷ The phrase "rules or regulations" includes the provisions of the Internal Revenue Code, temporary or final Treasury regulations issued under the Code, and revenue rulings or notices (other than notices of proposed rulemaking) issued by the Internal Revenue Service and published in the Internal Revenue Bulletin.⁸⁸ A disregard of rules or regulations is "careless" if the taxpayer does not exercise reasonable diligence to determine the correctness of a return position that is contrary to the rule or regulation.⁸⁹ A disregard is "intentional" if the taxpayer knows of the rule or regulation that is disregarded.⁹⁰ A taxpayer who takes a position contrary to a revenue ruling or notice has not disregarded the ruling or notice if the contrary position has a realistic possibility of being sustained on its merits.⁹¹ While Taxpayer researched the issue prior to reporting the position on its tax return, its analysis misreads the regulation and the case law interpreting the regulation. Given Taxpayer's knowledge, sophistication, and experience, Taxpayer's analysis of the applicable authorities reflects that Taxpayer's efforts did not reflect an attempt to determine its correct tax liability. As discussed in this memo and in the Form 886-A explaining the underlying issue, Taxpayer does not have a realistic possibility of being sustained on the merits. Accordingly, Taxpayer disregarded the rules or regulations.

⁸⁵ See, e.g., *Xcel Energy, Inc. v. U.S.*, 237 F.R.D. 416, 419 (D. Minn. 2006) (holding that the opinion of an IRS employee (a revenue agent) was irrelevant because opinions of tax professionals are specifically excluded in the list of authorities in Treas. Reg. § 1.6662-4(d)(3)(iii)).

⁸⁶ Taxpayer's Memo.

⁸⁷ Treas. Reg. § 1.6662-3(b)(2).

⁸⁸ Treas. Reg. § 1.6662-3(b)(2).

⁸⁹ Treas. Reg. § 1.6662-3(b)(2).

⁹⁰ Treas. Reg. § 1.6662-3(b)(2).

⁹¹ Treas. Reg. § 1.6662-3(b)(2).

Argument 4: Reasonable Cause Because Research Supported by [REDACTED]'s Cost Segregation Study

Taxpayer states that when it filed its [REDACTED] tax return, it did extensive research “in support of” its position on the parking deck, which was “supported by the issuance of a study provided by a public accounting firm with technical expertise in the subject matter.”⁹² Taxpayer is referring to the cost segregation study prepared by [REDACTED]. The cost segregation study contains no analysis of the facts regarding the parking structures at issue – only conclusions in a spread sheet. Moreover, according to its terms, the cost segregation study is “not intended or written to be used, and it cannot be used, for the purpose of avoiding tax penalties that may be imposed on the taxpayer.”⁹³

To determine whether a taxpayer reasonably relied in good faith on tax advice, all facts and circumstances are considered, and the advice must be based on all pertinent facts and circumstances.⁹⁴ Because the cost segregation study lacks the factual information upon which its conclusions are based, Taxpayer has not shown that the advice is based on all pertinent facts and circumstances. Moreover, the cost segregation study states that it cannot be used for purposes of avoiding tax penalties. Taxpayer is a large corporate taxpayer with an [REDACTED]. Based on these deficiencies, it was not reasonable for Taxpayer to have relied on the cost segregation study as a defense to an accuracy-related penalty.⁹⁵

Argument 5: Reasonable Cause Because Coordinated Issue Paper Issued After Taxpayer Filed Tax Return

Taxpayer states that because the coordinated issue paper regarding open-air parking structures was issued [REDACTED] after it filed its tax return, “there was no reason to believe our position was even remotely questionable at the time we filed our return” and therefore Taxpayer meets the reasonable cause and good faith exception to any accuracy-related penalty.⁹⁶

By way of background, a coordinated issue paper is administrative guidance specific to the IRS Large Business & International Division (formerly the Large and Mid-Size Business Division) that provides guidance to address compliance issues and is generally binding on all IRS examiners.⁹⁷ A coordinated issue paper is not “authority”

⁹² Taxpayer's Memo. [REDACTED].

⁹³ Cost segregation study [REDACTED].

⁹⁴ Treas. Reg. § 1.6664-4(c)(1); Neonatology Assocs., P.A. v. Commissioner, 115 T.C. 43, 98 (2000), aff'd 299 F.3d 221 (3d Cir. 2002).

⁹⁵ Treas. Reg. §§ 1.6664-4(b)(1) and 1.6664-4(c)(1)(i); Abarca v. Commissioner, T.C. Memo. 2012-245 (finding no reasonable cause and good faith when taxpayer has not demonstrated that the advice was based on taxpayer's facts); Dyer v. Commissioner, T.C. Memo. 2012-224 (same).

⁹⁶ Taxpayer's Memo. [REDACTED].

⁹⁷ IRM 4.51.2.4 (12-09-2005).

for purposes of determining reasonable basis or substantial authority.⁹⁸ More importantly, however, the legal authority (*i.e.*, cases and regulations) upon which the analysis in the coordinated issue paper is based existed well before Taxpayer filed its tax return and is authority for purposes of evaluating reasonable basis. That Taxpayer disregarded the analysis in those authorities does not demonstrate that Taxpayer had reasonable cause and acted in good faith.

Finally, _____, a draft coordinated issue paper was made available to the _____ on _____

_____ highlighting the open-air parking structure issue and the relevant legal authorities.⁹⁹ That Taxpayer continued to disregard the relevant authorities after this circulation again fails to demonstrate that Taxpayer had reasonable cause and acted in good faith.

Argument 6: Reasonable Cause Based on _____

The _____ presentation that Taxpayer attended at the _____ does not provide Taxpayer with reasonable cause for its position that the parking structures are land improvements. First, the presentation slides do not conclude that an open-air parking structure is a land improvement; the slides conclude, that certain regulations other than section 1.48-1(e), which governs this issue, “support the argument that parking structures belong in the land improvement category.”¹⁰⁰ An analysis of irrelevant authority – in light of the experience, knowledge, and education of the _____, with more than _____ of experience as a _____ – does not indicate reasonable cause.¹⁰¹ Moreover, the slides also state that the information “cannot be applied to a specific situation without appropriate professional advice,” and “use of words below such as ‘is,’ ‘should,’ ‘would,’ ‘will,’ etc. are not indicative of the likely opinion level that could be reached on each of the proposed transactions or issues.”¹⁰² The _____ presentation is not based on Taxpayer’s specific facts and therefore cannot provide Taxpayer with reasonable cause.¹⁰³

⁹⁸ Treas. Reg. § 1.6662-4(d)(3)(iii).

⁹⁹ Again, note that the Cost Segregation Audit Technique Guide (Jan. 2005) includes field directives for the retail industry (issued 12/16/2004), the biotechnology industry (issued 11/28/2005), and the auto dealership industry (issued 2/25/2008), each of which categorize parking structures as 39-year property describing them as “Any structure or edifice the purpose of which is to provide parking space. Includes, for example, garages, parking ramps, or other parking structures.”

¹⁰⁰ _____ presentation, slide _____.

¹⁰¹ Treas. Reg. § 1.6664-4(b)(1) (“Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law **that is reasonable** in light of all the facts and circumstances, **including the experience, knowledge, and education of the taxpayer.**”) (Emphasis added.)

¹⁰² _____ presentation, slide _____.

¹⁰³ Treas. Reg. §§ 1.6664-4(b)(1) and 1.6664-4(c)(1)(i); Abarca v. Commissioner, T.C. Memo. 2012-245 (finding no reasonable cause and good faith when taxpayer has not demonstrated that the advice was based on taxpayer’s facts); Dyer v. Commissioner, T.C. Memo. 2012-224 (same).

Similarly, the _____ memo, while addressed to Taxpayer, does not discuss any particular parking structure. Rather, the memo is a “summary discussion.”¹⁰⁴ The memo states that it is limited to “the described facts,” but none of Taxpayer’s facts are provided or analyzed.¹⁰⁵ Further, the memo states that it is “not intended to be a formal opinion of tax consequences, and, thus, may not contain a full description of all the facts or a complete exposition and analysis of all relevant tax authorities.”¹⁰⁶ In fact, the memo omits many relevant tax authorities that provide contrary analysis. The memo states that it “is not binding on the IRS or the courts and should not be considered a representation, warranty, or guarantee that the IRS or the courts will concur with our conclusions.”¹⁰⁷

The memo suggests classifying parking structures as land improvements, concluding that a parking structure (generally) does not meet the definition of a “building.” _____ suggestion is notwithstanding the discussion in the memo of the “function test” in section 1.48-1(e), which states that a structure is a building if a purpose is, for example, to provide parking.¹⁰⁸ The memo acknowledges that in most cases, a parking structure will meet the “function test since parking is one of the enumerated purposes in the regulation,” but then states that the appearance test is the “decisive factor” because a parking structure does not have walls or a roof, is open to the elements, and is not designed to provide shelter.¹⁰⁹ The memo contains no discussion of the numerous cases that elevate the function test over the appearance test, or of the cases that have disregarded the argument that “walls” are necessary under the appearance test.

As with the cost segregation study and the presentation, Taxpayer has not demonstrated that the advice in the _____ memo is based on all pertinent facts regarding Taxpayer’s parking structures.¹¹⁰ Again, Taxpayer is a large, sophisticated taxpayer with an experienced in-house corporate tax department. The disclaimer in the _____ memo that the advice “should not be considered a representation ... that the IRS or the courts will concur with our conclusions” should have alerted Taxpayer that this memo would not provide a reasonable cause defense.¹¹¹ Taxpayer has not demonstrated that it has reasonable cause and acted in good faith for its position that the parking structures at issue are properly classified as land improvements.

104 _____ Memo .
 105 _____ Memo .
 106 See _____ Memo .
 107 _____ Memo .
 108 _____ Memo .
 109 _____ Memo .

110 Treas. Reg. § 1.6664-4(c)(1)(i).

111 See Curcio v. Commissioner, 689 F.3d 217, 229 (2d Cir. 2012) (reliance on a letter from advisor that “made no guarantees” as to the tax treatment at issue and “specifically warned that the Commissioner could disallow petitioners’ deductions” did not reflect that the taxpayers conducted an investigation sufficient to avail themselves of a “good faith” defense).

Case Development, Hazards, and Other Considerations

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Note that the initial decision of whether to apply the penalty rests with the supervisor of the person proposing the penalty (e.g., the IRS case manager). Therefore, this memorandum addresses whether you have a sufficient legal basis to apply the penalty, not whether the penalty should be proposed.

This advice was reviewed by the Office of Chief Counsel, Associate Offices for Income Tax and Accounting and Procedure and Administration.

PAUL T. BUTLER
Associate Area Counsel (Washington)
(Large Business & International)

By: _____
Kimberly B. Tyson
Senior Attorney (Greensboro)
(Large Business & International)

¹¹² Section 6751(b)(1); see also IRM 20.1.1.2.3 (11-25-2011).