30 "Wrongs" Do Not Make a Right: Revealing Extraordinary IRS Actions in Conservation Easement Disputes

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Many of the procedures that the IRS is implementing now in the syndicated conservation easement transactions context are far from ordinary and could have negative ramifications for all taxpayers in the future.

Many of us, as student athletes furious about some perceived dirty play by the opposing team, vowed retaliation at the first opportunity. Our coaches, of course, tried to dissuade us, explaining that in sports, as in life, two wrongs do not make a right. In other words, they tried to teach stubborn, slighted youngsters a tough lesson, which is that it is inappropriate to do bad things just because someone else supposedly did them first. This lesson applies in the tax context, too.

The Internal Revenue Service ("IRS") believes that partnerships that engaged in what it calls syndicated conservation easement transactions ("SCETs") have claimed excessive tax deductions based on inflated appraisals. The partnerships, on the other hand, point to congressional support for easement donations for over 50 years, the significant amount of pre-donation due diligence performed with respect to each property, full disclosure to the IRS, and reliance on a long list of independent, qualified experts in various fields. The two sides simply disagree, which is fine. What is not fine, though, is that in attacking SCETs, the IRS has utilized a large number of extraordinary tactics that might have negative effects on *all* taxpayers in the future.

Most tax issues are complex, nuanced, and subject to multiple interpretations. The result is that few things in tax are black or white, right or wrong. However, solely for purposes of underscoring the disproportionate measures that the IRS is taking in SCET

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battles, this article examines 29 "wrongs" committed by the IRS. Together with the supposed "wrong" by the partnerships, of relying on certain appraisals, these total 30. Considering matters from a macro perspective, this article presents the question of whether the 29 current "wrongs" perpetrated by the IRS in challenging SCETs now are producing a "right" for all taxpayers in the long term.

Overview of Conservation Easements and Tax Deductions

Taxpayers who own undeveloped real property have several choices. For instance, they might (i) hold the property for investment purposes, selling it when it appreciates sufficiently, (ii) determine how to maximize profitability from the property and do that, regardless of the negative effects on the local environment, community, or economy, or (iii) voluntarily restrict certain future uses of the property, such that it is protected forever for the benefit of society. The third option, known as donating a "conservation easement," not only achieves the goal of environmental protection, but also triggers another benefit, tax deductions for donors.[1]

Taxpayers cannot donate an easement on just any property and claim a tax deduction; they must demonstrate that the property has at least one acceptable "conservation purpose."[2]

Taxpayers memorialize the donation by filing a public Deed of Conservation Easement or similar document ("Deed"). In preparing the Deed, taxpayers often coordinate with the land trust to identify certain limited activities that can continue on the property after the donation, without interfering with the Deed, without prejudicing the conservation purposes, and, hopefully, without jeopardizing the tax deduction.[3] These activities are called "reserved rights."[4]

The IRS will not allow the tax deduction stemming from a conservation easement, unless the taxpayer obtains, before making the donation, "documentation sufficient to establish the condition of the property at the time of the gift."[5] This is referred to as the Baseline Report. [6]

The value of the conservation easement is the fair market value ("FMV") of the property at the time of the donation.[7] The term FMV ordinarily means the price on which a willing buyer and willing seller would agree, if neither party was obligated to participate in the transaction, and if both parties had reasonable knowledge of the relevant facts.[8] The best evidence of the FMV of an easement would be the sale price of other conserved properties that are comparable in size, location, etc. The IRS recognizes, though, that it is difficult, if not impossible, to find them.[9] Consequently, appraisers often must use the before-and-after method instead. This means that an appraiser must determine the highest and best use ("HBU") of the property *and* the corresponding FMV twice. First, the appraiser calculates the FMV as if the property were put to its HBU, which generates the "before" value. Second, the appraiser identifies the FMV, taking into account the restrictions on the property imposed by the conservation easement, which creates the "after" value.[10] The difference between the "before" and "after" values of the property, with certain adjustments, produces the amount of the donation.

A property's HBU is the most profitable use for which it is adaptable and needed in the reasonably near future.[11] The HBU must also be physically possible, legally permissible, financially feasible, and maximally productive.[12] Importantly, valuation in the easement context does not depend on whether the owner has actually put the property to its HBU in the past.[13] The HBU can be *any* realistic potential use of the property.[14] Common HBUs are construction of a residential community,

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1 Section 170(f)(3)(B)(iii); Reg. 1.170A-7(a)(5); Section 170(h)(1); Section 170(h)(2); Reg. 1.170A-14(a); Reg. 1.170A-14(b)(2).

2 Section 170(h)(4)(A); Reg. 170A-14(d)(1); S. Rept. 96-1007, p. 10 (1980). Acceptable conservation purposes are as follows: (i) it preserves land for outdoor recreation by, or the education of, the general public; (ii) it preserves a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem; (iii) it preserves open space (including farmland and forest land) for the scenic enjoyment of the general public and will yield a significant public benefit; (iv) it preserves open space (including farmland and forest land) pursuant to a federal, state, or local governmental conservation policy and will yield a significant public benefit; or (v) it preserves a historically important land area or a certified historic structure.

3 Reg. 1.170A-14(b)(2).

4 IRS, *Conservation Easement Audit Techniques Guide* (rev. 11/4/2016), p. 23; *see also* Reg. 1.170A-14(e)(2) and (3).

5 Reg. 1.170A-14(g)(5)(i).

6 Reg. 1.170A-14(g)(5)(i). The Baseline Report may feature several things, including, but not limited to, (i) survey maps identifying the property lines and other contiguous or nearby protected areas, (ii) a map of the area drawn to scale showing existing man-made improvements or incursions, vegetation, flora and fauna, animal breeding and roosting areas, migration routes, land use history, and distinct natural features, (iii) an aerial photograph of the property taken as close as possible to the date of the donation, and (iv) on-site photographs taken at various locations on the property.

7 Section 170(a)(1); Reg. 1.170A-1(c)(1).

8 Reg. 1.170A-1(c)(2).

9 *See Conservation Easement Audit Techniques Guide, supra* note 4, p. 41.

10 *Id.*

11 Olson v. United States, 292 U.S. 246, 255 (1934).

12 Esgar Corp., 744 F.3d 648, 659 n.10 (CA-10, 2014).

13 *Id.* at 657.

14 Symington, 87 TC 892, 896 (1986).

15 *See Conservation Easement Audit Techniques Guide, supra* note 4, pp. 24-30; IRS Publication 1771, *Charitable Contributions—Substantiation and Disclosure Requirements*; IRS Publication 526, *Charitable Contributions*; Section 170(f)(8); Section 170(f)(11); Reg. 1.170A-13; Notice 2006-96; TD 9836.

16 Tax Reform Act of 1969, P.L. 91-17, section 201 (1969); U. S. House of Representatives, Tax Reform Act of 1969, 91st Cong., 1st Sess., Rep't No. 91-782 (12/21/1969); *See also* Tax Reform Act of 1976, P.L. 94-455, section 2124(e) (1976); *See also* Tax Reduction and Simplification Act of 1977, P.L. 95-30, section 309 (1977). Notably, the IRS first recognized tax deductions for charitable contributions of partial interests in real property several years earlier, in 1964. *See* Rev. Rul. 64-205.

17 Tax Treatment Extension Act, P.L. 96-541, section 6(a) (1980); U.S. Senate, Tax Treatment Extension Action of 1980, 96th Cong., 2d Sess., Rep't No. 96-1007 (9/30/1980).

18 U.S. Senate, Tax Treatment Extension Action of 1980, 96th Cong., 2d Sess., Rep't No. 96-1007 (9/30/1980), p. 9.

19 Pension Protection Act, P.L. 109-280, sections 1206 and 1219.

20 Food, Conservation, and Energy Act, P.L. 110-246, section 15302 (2008); Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act, P.L. 111-312, section 723 (2010); American Taxpayer Relief Act, P.L. 112-240, section 206 (2013); Tax Increase Prevention Act, P.L. 113-295, section 106 (2014).

21 Protecting Americans from Tax Hikes Acts, P.L. 114-113, section 111 (2015).

22 Sheppard, "Analyzing Five Obscure IRS Actions in 2020 with Serious Implications for Conservation Easement Disputes," 133 JTAX 11 (July 2020);

creation of a mixed-use development, mining of all types, and establishment of a solar energy farm.

Properly claiming the tax deduction from an easement donation is surprisingly complicated. It involves a significant amount of actions and documents. Among other things, the taxpayer must (i) obtain a "qualified appraisal" from a "qualified appraiser," (ii) demonstrate that the land trust is a "qualified organization," (iii) obtain a Baseline Report adequately describing the condition of the property and the reasons why it is worthy of protection, (iv) complete a Form 8283 (Noncash Charitable Contributions), (v) assuming that the taxpayer is a partnership, file a timely Form 1065, enclosing Form 8283 and the qualified appraisal, and (vi) receive from the land trust a "contemporaneous written acknowledgement," both for the easement itself and for any stewardship fee donated to finance perpetual protection of the property.[15]

Longstanding Congressional Support

Congress has generally recognized the deductibility of a partial interest in real property for more than five decades.[16] Then, in 1980, Congress enacted Section 170(h), which allows landowners to claim a tax deduction for the donation of conservation easements.[17] Congress explained the reasons for codifying this environmental and financial benefit:

> The committee believes that the preservation of our country's natural resources and cultural heritage is important, and the committee recognizes that conservation easements now play an important role in preservation efforts . . . [T]he committee found it appropriate to expand the type of transfers which will qualify as deductible contributions in certain cases where the contributions are likely to further significant conservation goals without presenting significant potential for abuse.[18]

Section 170(h) has been modified and enhanced several times since its introduction. For instance, in 2006, Congress added a definition of "qualified appraiser," lowered the threshold at which the IRS could assert penalties based on erroneous appraisals, and made the tax benefit even more appealing to taxpayers by allowing them to deduct up to 50 percent of their adjusted gross incomes (instead of 30 percent) and to carry forward unused deductions for up to 15 years (instead of five years).[19] Congress later extended these enhanced benefits several times, from 2008 through 2014.[20] It made them permanent in 2015.[21]

IRS Enforcement Actions—Identifying the 29 "Wrongs"

Despite historical support by Congress, the IRS and the Department of Justice ("DOJ") have been attacking certain partnerships that donated conservation easements to charities. That is common knowledge. What is not well known, though, is that the IRS and DOJ are utilizing a long list of aggressive, unique, and sometimes questionable tactics. This article is the third in a series focused on this reality.[22]

Wrong #1—Labeling Donations "Listed Transactions"

The IRS issued Notice 2017-10 in late December 2016, labeling syndicated conservation easement transactions ("SCETs") as "listed transactions."[23] This triggered the need for various parties to file Forms 8886, *Reportable Transaction Disclosure Statement* and Forms 8918, *Material Advisor Disclosure Statement*, providing the IRS lots of details that it utilizes in its enforcement activities.[24]

Wrong #2—Implementing a Compliance Campaign

The IRS launched a "compliance campaign" centered on SCETs, devoting dozens of specialized Revenue Agents and other IRS personnel to the cause.[25]

Wrong #3—Attacks Focused on "Technical" Flaws

The IRS has consistently stated that the main problem with SCETs is inflated valuations. However, the IRS's primary focus in tax disputes thus far has been on "technical" flaws, that is, supposed problems with the Deed, Baseline Report, Qualified Appraisal, Form 8283, or other documents affiliated with donations. The Audit Technique Guide ("ATG") published by the IRS contains a list of technical duties that IRS personnel are encouraged to pursue.[26]

To put things into perspective, even attorneys affiliated with organizations *strongly opposed* to SCETs have criticized the IRS's approach of challenging supposed "technical" flaws. For instance, a recent article, playing on an

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Sheppard, "20 Recent IRS Enforcement Actions in Conservation Easement Disputes: Awareness and Preparation are Key," 134 JTAX 15 (March 2021).

[23] Notice 2017-10, 2017-4 IRB 544 (12/23/2016). This covered both SCETs and other "substantially similar transactions."

[24] *Id.*

[25] IRS Information Release 2020-130 (6/25/2020).

[26] *Conservation Easement Audit Techniques Guide, supra* note 4, pp. 78-81. The ATG highlights the following possible "technical" violations on which the IRS can claim that a donation related to a SCET is worth $0: The donation of the easement lacked charitable intent because there was some form of *quid pro quo* between the partnership and the charitable organization. The donation of the easement was conditioned on receipt by the partnership of the full tax deduction claimed on its Form 1065. The land trust failed to issue a "contemporaneous written acknowledgement" letter. The appraisal was not attached to the Form 1065 filed by the partnership. The appraisal was not prepared in accordance with the Uniform Standards of Professional Appraisal Practice. The appraisal fee was based on a percentage of the easement value. The appraisal was not timely, in that it was not sufficiently proximate to the making of the donation or the filing of the Form 1065 by the partnership. The appraisal was not a "qualified appraisal." The appraiser was not a "qualified appraiser." The Form 8283 was missing, incomplete, or inaccurate. Not all appraisers who participated in the analysis signed Form 8283. The Baseline Report insufficiently described the condition of the property. The conservation easement was not "granted" in perpetuity. The conservation easement was not "protected" in perpetuity. Any mortgages or other encumbrances on the property were not satisfied or subordinated to the easement before the donation. The Deed contains an improper clause regarding how the proceeds from a forced sale of the property upon extinguishment of the easement (*i.e.*, by condemnation, eminent domain, or some other type of governmental taking) would be allocated among the partnership and the land trust. The Deed contains an amendment clause, which, in theory, might allow the parties to modify the donation, after taking the tax deduction, in such a way as to undermine the conservation purposes. The Deed contains a merger clause, as a result of which the fee simple title to the relevant property and the easement might end up in the hands of the same party, thereby undermining the ability to protect the property forever. The Deed was not timely filed with the proper court or other location. The land trust was not a "qualified organization." The property lacks acceptable "conservation purposes."

"Alice in Wonderland" theme, is replete with scathing criticisms of the IRS. Take a gander at some of the stronger statements:

> [T]he IRS has propagated a house-of-cards construct of legal theories to challenge perpetual conservation easements, dragging both the Tax Court and the conservation community down a rabbit hole [and this] distorted view of the code and regulations has harmed the practice of land conservation.[27]
>
> The IRS now takes this "Off with their heads!" approach in all conservation easement challenges, regardless of the size of the deduction and whether the alleged problem is valuation, technical noncompliance, or a substantive issue.[28]
>
> Instead of operating in a land of reason and plain reading of the law, the IRS's mischaracterizations of the code and regulations cause the conservation community and the Tax Court to find themselves in Wonderland, where the Queen of Hearts indiscriminately orders decapitation over the slightest transgression.[29]
>
> The IRS's ongoing efforts to confound the Tax Court, create circuit conflicts, and eventually compel the Supreme Court to resolve this issue exemplifies the current upside-down state of land conservation law for tax deductible conservation easements. This is baffling given the straightforward framework created to evaluate qualification for tax deductions . . . .[30]
>
> Despite the IRS's hyper-attenuated focus on technical flaws, those errors do not actually undermine the merit or substance of the perpetual nature or conservation protections in conservation easements.[31]
>
> Unfortunately for all current and future conservation easement donors and holders, the IRS's path leads straight down the rabbit hole, with the Tax Court in tow. That won't change as long as the Tax Court refuses to hold the IRS accountable for fabricating its own rules outside the language of the code and regulations and without following required administrative procedures.[32]
>
> The IRS's intransigent refusal to disclose guidance for qualifying conservation tax deductions, and its tyrannical approach to declaring failures under the law only through pronouncements in audits and litigation, are poor tax policy and a gross disservice to taxpayers and Congress.[33]
>
> The IRS's plunge into matters beyond valuation and into elements intended and necessary for conservation easement durability and flexibility over perpetuity has caused a confusing legacy of Tax Court decisions built on a tottering tower of cards, in a Wonderland that subverts the true meaning of perpetuity in the code and regulations.[34]

Wrong #4—Predetermined and Vague Conclusions

The IRS has implemented a practice of issuing audit reports and notices of Final Partnership Administrative Adjustment ("FPAAs") claiming that *all* partnerships that engaged in an SCET should get a charitable deduction of $0 and should be severely penalized, *regardless* of the amount of pre-donation due diligence performed by the partnerships, strength of the conservation values, existence of multiple independent appraisals, etc. Particularly galling to taxpayers is the fact that, in issuing FPAAs triggering many years of expensive and stressful litigation, the IRS refuses to specify the factual, legal, or tax reasons for its attacks. Indeed, it often limits itself to alleging that the partnership should get a tax deduction of $0 because "[i]t has not been established that all the requirements of I.R.C Section 170 have been satisfied for the non-cash charitable contribution of a qualified conservation contribution." In addition to fully disallowing the easement-related deduction without providing justifications, the IRS proposes several alternative penalties, ranging in severity. The IRS invariably leads with "gross valuation misstatement," as it triggers the highest penalty equal to 40 percent of the ultimate tax liability.[35]

Wrong #5—Attempts to Enjoin Activities

The DOJ filed a Complaint in District Court seeking a permanent injunction against alleged organizers and appraisers, along with disgorgement of the proceeds that they obtained from their dealings with SCETs or SSTs.[36]

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27 Jay, "Perpetual Conservation Easements in Wonderland," The Exempt Organization Tax Review, vol. 87, May 2021, p. 373.

28 *Id.*, p. 374.

29 *Id.*, p. 400.

30 *Id.*, p. 736.

31 *Id.*, p. 748.

32 *Id.*, p. 751.

33 *Id.*, p. 751.

34 *Id.*, p. 756.

35 Section 6662; Section 6662A.

36 United States v. Zak, Clark, EcoVest Capital Inc., Solon, McCullough, and Teal, Case No. 1:18-cv-05774, D.C. Ga, Complaint filed 12/18/2018.

37 *See, e.g.,* IR-2019-47 (3/19/2019).

38 IR-2020-160 (7/16/2020).

39 U.S. Senate, Committee on Finance, "Syndicated Conservation Easement Transactions," 116th Cong., 2nd Sess., Senate Rep't No. 116-44 (August 2020), p. 105; Parillo, "Senate Finance Calls for Crackdown on Abusive Easement Deals," 2020 Tax Notes Today Federal 165-4 (8/26/2020); Parillo, "Syndicated Easement Crackdown Is Justified, Says Grassley," 2021 Tax Notes Today Federal 75-3 (4/20/2021).

40 U.S. Senate, Committee on Finance, "Syndicated Conservation Easement Transactions," 116th Cong., 2nd Sess., Senate Rep't No. 116-44 (August 2020), pp. 4 and 105.

41 *Id.*, p. 4.

42 IR-2019-182, "IRS Increases Enforcement Action on Syndicated Conservation Easements," 11/12/2019; IR-2019-213, "IRS Continues Enforcement Efforts in Conservation Easement Cases Following Latest Tax Court Decision," 12/20/2019; Richman, "Multiple Divisions Coming for Syndicated Conservation Easements," 2019 Tax Notes Today 220-3 (11/13/2019); Hoffman, "Conservation Easement Crackdown a Portent, Rettig Says," 2019 Tax Notes Today 221-9 (11/14/2019); Parillo, "IRS Is Building Up Its Easement Toolbox," 2019 Tax Notes Today 222-6 (11/15/2019); Parillo, "IRS Looking for Promoter Links as Easement Crackdown Grows," Tax Notes Today, Doc. 2019-47134 (12/13/2019); Parillo, "Syndicated Easement Players Getting Referred to OPR," 2020 Tax Notes Today Federal 223-5 (11/18/2020).

43 Parillo. "IRS Assigns Point Person on Promoter Investigations," Federal Tax Notes Today Doc. 2020-6890 (2/25/2020); IR-2020-41 (2/24/2020).

44 Parillo, "IRS Looking for Promoter Links as Easement Crackdown Grows," Tax Notes, Doc. Number 2019-47134 (12/13/2019).

45 IR-2021-88 (4/19/2021); Hoffman, "IRS Names Acting Chief of Office of Promoter Investigations," 2021 Tax Notes Today Federal 75-1 (4/20/2021).

46 IR-2021-88 (4/19/2021).

Wrong #6—Name Calling

The IRS featured SCETs on its "dirty dozen" list for several years.[37] These transactions were absent from the list for 2020, but the IRS indicated its plan to issue a series of separate press releases emphasizing "the illegal schemes and techniques" that taxpayers use "to avoid paying their lawful tax liability," including "fraudulent conservation easements."[38]

Wrong #7—Congressional Inquiry

The Senate Finance Committee conducted an inquiry and issued a report in 2020, suggesting that SCETs constitute "abusive tax shelters."[39] However, the report did not offer any specific recommendations about how to address perceived problems, and it underscored that the Section 170(h) deduction should remain.[40] In this regard, the report explained that Congress, the IRS, and the Treasury Department "should take further action to preserve the integrity of the conservation-easement tax deduction."[41]

Wrong #8—Stoking Fires in the Media

The IRS has engaged in a media blitz, disseminating data via news releases, tax conference presentations, and quotes in articles. The IRS emphasizes that it is (i) pursuing promoters, appraisers, return preparers, material advisors, accommodating entities, charitable organizations, and others, (ii) making referrals to the Office of Professional Responsibility ("OPR"), (iii) raising a long list of technical, procedural, legal and tax arguments in disputes, while constantly trying to develop more, (iv) asserting all possible civil penalties, (v) conducting simultaneous civil examinations and criminal investigations, (vi) contracting with appraisers from the private sector to handle the workload, and (vii) litigating a large number of cases in Tax Court.[42]

Wrong #9—Pursuit of Supposed "Promoters"

In 2020, the IRS appointed a "Promoter Investigations Coordinator," who is in charge of coordinating with the Civil Division, Criminal Investigation Division, Chief Counsel, and OPR to develop enforcement strategies.[43] The IRS, likely at the behest of the new Promoter Investigations Coordinator, initiated various "promoter investigations" of persons who organized partnerships that engaged in SCETs.[44]

More recently, in April 2021, the IRS announced the formation of the "Office of Promoter Investigations," designed to "further expand on the efforts of the Promoter Investigations Coordinator" that began the prior year.[45] The IRS was clear in that this new development focuses on various items, with SCETs ranking first on the list.[46]

Wrong #10—Searching for Fraud

In March 2020, the IRS proclaimed that it had formed the new "Fraud Enforcement Office."[47] The IRS augmented this news soon thereafter, indicating that it had hired a "National Fraud Counsel."[48] The IRS also recently issued two Chief Counsel memoranda describing the methods by which the IRS can apply the civil fraud penalty against SCET partnerships.[49] Because the memoranda were issued in response to "questions" from the National Fraud Counsel, because the "questions" were extremely basic, and because the "questions" could have referenced *all* partnerships instead of just those that engaged in SCETs, one might speculate that the memoranda were intended by the IRS as a warning to partnerships and as a nudge to Revenue Agents to allege fraud or worse.[50]

Wrong #11—Mandating More Disclosure

The IRS introduced a new Form 8886 in early 2020. It adds three new subparts to Line 7, all of which obligate a taxpayer to reveal yet more details about the tax benefits from participation in reportable transactions, like SCETs.[51] The new, expanded Form 8886, unnoticed by most taxpayers and their advisors, should trigger some degree of concern. According to an update to Congress, between three and nine percent of Forms 8886 in recent years were incomplete, and the IRS warned that "[f]urther analysis and/or examination is being performed to determine if penalties are appropriate."[52] New Form 8886 creates yet more chances for participants to get tripped up.

Wrong #12—Swifter Summonses

The IRS issued a legal memo in February 2020 containing important

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47 IRS News Release IR-2020-49 (3/5/2020) (The IRS emphasized that the new director is a veteran of the Criminal Investigation Division, having previously worked as a Special Agent, Special Agent in Charge, and Executive Director of International Operations for Criminal Investigation).

48 IR-2020-102 (5/26/2020).

49 IRS Chief Counsel Memorandum AM-2020-010 (10/5/2020) (called "Determining the Fraud Penalty in TEFRA Syndicated Conservation Easement Cases"); "IRS Describes Penalty Procedures for Conservation Easement Transactions," 2020 Tax Notes Federal Today 197-42 (10/5/2020); IRS Chief Counsel Memorandum AM-202044009 (10/23/2020) (called "Determining the Fraud Penalty in BBA Syndicated Conservation Easement Cases").

50 Richman. "IRS Talking to Prosecutors about Conservation Easements," 2020 Tax Notes Today Federal 223-6 (11/18/2020) (stating that the fight against SCETs "includes not only potential civil fraud penalties but also an open dialogue between the IRS and [DOJ] prosecutors").

51 Instructions for Form 8886, *Reportable Transaction Disclosure Statement* (rev. Dec. 2019), p. 1. The "What's New" portion of the Instructions for Form 8886 states that "[n]ew Lines 7b, 7c and 7d request total dollar amounts of your tax benefit(s), number of years of anticipated benefit, and your total investment or basis in the reportable transaction."

52 "Land Trust Alliance Calls for Action on Conservation Easements," 2020 Tax Notes Today Federal 38-9, Document 2020-7149 (2/25/2020) (see attached letter from IRS Commissioner Rettig to Senator Grassley, as Chairman of the Senate Finance Committee, dated 2/12/2020); Parillo. "No Notable Decrease in Syndicated Easement Deals," 2020 Tax Notes Today Federal 39-1, Document 2020-7321 (2/27/2020).

53 Tax Notes Doc. 2020-7524 (2/25/2020), consisting of LB&I-04-0220-004. This IRS guidance only applies to the Large Business & International Division, whose examination procedures differ from those used by the Small Business and Self-Employed Division.

54 IRM § 4.46.4.6.3 (12/13/2018) and IRM Exhibit 4.46.4-2.

55 IRM Exhibit 4.46.4-2.

56 Tax Notes Doc. 2020-7524 (2/25/2020), consisting of LB&I-04-0220-004.

57 Lee, "IRS Emphasizes Summons Power in Conservation Easement Cases," 2020 Tax Notes Today Federal 222-3 (11/17/2020) (attaching a copy of the IRS legal memo whose express subject is "Use of Summons and Summons Enforcement in Syndicated Conservation Easement Cases, Reportable Transactions, and Other Abusive Tax Avoidance Transactions").

changes to the audit process involving "listed transactions," such as SCETs.[53] The normal Information Document Request ("IDR") enforcement process features "three graduated steps." Revenue Agents first issue a Delinquency Notice, followed by a Pre-Summons Letter, and, ultimately, a Summons.[54] This multi-layer process generally "is mandatory and has no exceptions."[55] Thanks to the recent IRS legal memorandum, the previous "mandatory" process is no longer required when dealing with SCETs; Revenue Agents will now adhere to swifter Summons procedures.[56]

Doubling down on this mindset, the IRS issued another legal memorandum in November 2020, which provides guidance about the use of Summonses.[57] To counter alleged delays and other impediments to audits, the IRS legal memo instructs audit personnel to "use all available administrative tools," promptly issue Summonses, and, if full compliance does not ensue, initiate Summons enforcement in the courts.[58]

Wrong #13—Neglecting the Facts

Revenue Agents have traditionally issued taxpayers an acknowledgement-of-facts IDR at the end of the audit process. The purpose was to ensure that both the taxpayers and the IRS agreed on the key facts, such that the dispute before the Appeals Office and/or Tax Court could focus on legal/tax issues.[59] The IRS has underscored the benefits of the acknowledgement-of-facts IDR for years, suggesting that it facilitates resolution of issues during the audit phase, saves resources on both sides, avoids Appeals Officers referring cases back to Revenue Agents for further development, and allows the IRS to prepare the most comprehensive audit reports and FPAAs possible.[60] These positive attributes notwithstanding, the IRS changed its tune in February 2020, when it issued a legal memorandum dictating that Revenue Agents who audit "listed transactions," like SCETs, are no longer required to send taxpayers acknowledgement-of-facts IDRs.[61] One might interpret this as disinterest by the IRS in getting the facts straight before pushing cases toward litigation.

Wrong #14—Revoking Procedural Protections for Appraisers

The Internal Revenue Manual ("IRM") has historically contained a multi-level review process designed to ensure that an appraiser has engaged in a serious degree of wrongdoing before assessing penalties, making referrals to OPR, etc.[62] The prior procedures required analysis by at least five experienced IRS employees (*i.e.*, Revenue Agent, Examining Appraiser, Primary Review Appraiser, Secondary Review Appraiser, and Review Manager) before Section 6695A penalties could be assessed.[63] However, the IRS issued a memorandum in 2020 whose purpose was remarkably clear: "Eliminating the multi-tiered review process for IRC 6695A appraiser penalty cases."[64] Under the recent memorandum, if an Examining Appraiser determines a gross valuation misstatement while, say, auditing an SCET, he simply needs to obtain written approval from his supervisor and then notify the Revenue Agent that the Section 6695A penalty applies.[65] Moreover, the memorandum states that Revenue Agents are solely responsible for assessing the Section 6695A penalty, preparing the related report, and closing the penalty case.[66] In summary, the prior procedures required input by at least five experienced IRS employees before seeking penalties against appraisers, whereas now a Revenue Agent, who likely has no training whatsoever in the field of valuation, makes this decision alone or with input from just one Examining Appraiser.

Wrong #15—Fomenting Discord with Settlement Initiative

Leveraging the momentum from its recent Tax Court victories based on inadvertent flaws in Deeds, Baseline Reports, Forms 8283, and/or appraisals, the IRS issued a news release in June 2020 describing a potential path to resolution ("Settlement Initiative").[67] It then started sending offer letters to eligible partnerships. Opinions vary on the Settlement Initiative, of course, with many interpreting it as a big stick, as opposed to an olive branch, from the IRS.[68]

Those characterizing the Settlement Initiative as just another IRS enforcement tactic point to several things, including the fact that participation does not serve to limit or prohibit the IRS from later asserting criminal penalties, promoter penalties, appraiser penalties, return preparer penalties, or any other sanction.[69] Skeptics also underscore the

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[58] *Id.*

[59] IRM § 4.46.4.2 (12/13/2018) and IRM § 4.46.4.10 (12/13/2018).

[60] IRM § 4.46.4.10 (12/13/2018); IRS Publication 5125, *Large Business & International Examination Process* (2-2016).

[61] Tax Notes Doc. 2020-7524 (2/25/2020), consisting of LB&I-04-0220-004.

[62] IRM § 20.1.12.7 (12/18/2017).

[63] IRM § 20.1.12.7.4 (12/18/2017).

[64] Tax Notes Doc. 2020-3440 (1/22/2020), consisting of LB&I-20-0120-001.

[65] *Id.*

[66] *Id.*

[67] IRS Information Release 2020-130 (6/25/2020); IRS Information Release 2020-152 (7/13/2020); Sheppard, "Question Remain about Conservation Easement Settlement Initiative," 168(12) Tax Notes Federal 2219 (2020); Sheppard, "Conservation Easement Settlement Initiative: More IRS Guidance, More Uncertainty," 169(7) Tax Notes Federal 1085 (2020).

[68] Parillo. "Partner Buy-In Rule Could Spoil Some IRS Easement Settlement," Tax Analysts Doc. 2020-24312 (6/26/2020); Parillo. "Criticism of Easement Settlement Deal Doesn't Worry IRS," 2020 Tax Notes Tax Federal 135-4, Doc. 2020-26950 (7/15/2020); Parillo, "IRS Reaches First Settlement of Syndicated Easement Case," 2020 Tax Notes Today Federal 169-1 (9/1/2020); IRS Information Release 2020-196 (8/31/2020).

[69] Section 7121(b).

[70] IRS Information Release 2020-152 (7/13/2020) (support for the divide-and-conquer theory is rooted in some caustic statements by the IRS).

[71] Section 7525.

[72] Section 7525(a)(1).

[73] Section 7525(a)(1), Section 7525(a)(2), Section 7525(a)(3); Section 7525(b); 31 U.S.C. section 330; and 31 C.F.R. section 10.3.

[74] *See, e.g.,* United States v. Microsoft Corp. et al., 125 AFTR2d 2020-547 (DC Wash., 2020).

[75] Reg. 601.106(b); *See also* Reg. 601.103(c)(1).

[76] Rev. Proc. 87-24; Prop. Reg. 601.106(e)(3)(i)(A); IRS Restructuring and Reform Act of 1998, P.L. 105-206, Section 1001(4); IRM § 33.3.6 (8/11/2004); Section 7803(a)(3)(D) and (E), as enacted by Protecting Americans from Tax Hikes Act of 2015, P.L. 11-4-113 (2015); *See also* Joint Committee on Taxation, "Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029," JCX-144-15 (12/17/2015); Taxpayer First Act of 2019. P.L. 116-25 (7/1/2019), Section 1001; *See also* Joint Committee on Taxation. "Description of H.R. 1957, The Taxpayer First Act of 2019." JCX-15-19 (4/1/2019).

differential treatment contemplated by the Settlement Initiative. So-called "Category One Partners" get hit with a charitable deduction of $0 and a 40 percent penalty, plus they must pay the entire amount right away. By contrast, "Category Two Partners" can claim an ordinary tax deduction equal to the out-of-pocket costs paid to participate in the SCET. Moreover, their penalties are not 40 percent of the tax underpayment, but rather 10 percent to 20 percent, depending on their return-on-investment ratio. This large disparity might put Category One Partners at odds with Category Two Partners, triggering anger, distrust, infighting, legal actions, etc. A cynic might speculate that this is exactly what the IRS intended, a classic divide-and-conquer strategy.[70]

Wrong #16—Efforts to Undermine Privilege

The IRS has become more aggressive in its efforts to gather all potentially relevant data (including pre-donation communications involving accountants and others), despite the fact that they might be confidential. This scenario often arises when partnerships decline to provide the IRS copies of correspondence with advisors on grounds that they are protected by the federally authorized tax practitioner ("FATP") privilege.[71]

This privilege generally provides that the protections applicable to communications between taxpayers and their attorneys extend to communications between taxpayers and FATPs.[72] However, these expanded protections *only* apply to (i) "tax advice," not return-preparation and other services, (ii) provided by a person who qualifies as an FATP, such as a certified public accountant, enrolled agent, registered tax return preparer, and others, (iii) involving non-criminal matters, (iv) in connection with an administrative or judicial tax matter, where the IRS or DOJ is a party, and (v) not regarding "tax shelters."[73]

The IRS has started trying to overcome the FATP privilege in SCET cases by arguing that the relevant advisors were not providing "tax advice" in the first place. It also contends that, even if the advisors were offering "tax advice," the privilege was later waived when the relevant information was forwarded to third parties. The IRS further suggests that SCETs are "listed transactions" pursuant to Notice 2017-10 and thus "tax shelters" and "a significant purpose" of the SCETs is federal income tax avoidance.[74]

Wrong #17—Denial of Review by Appeals Office

The IRS has declared that taxpayers have a "right" to seek review by the Appeals Office for many decades. Indeed, regulations issued more than five decades ago, in 1967, stated that when the IRS proposes tax adjustments, "the taxpayer has the right (and will be so advised by the district director) of administrative appeal to the Appeals organization."[75] The IRS and Congress have confirmed and modified this right several times over the years.[76]

Rev. Proc. 2016-22 is noteworthy in this regard. It confirmed that the IRS attorneys generally will refer docketed cases to the Appeals Office for settlement consideration but contained disclaimers.[77] It stated that IRS attorneys will *not* refer to the Appeals Office any docketed case featuring an issue that "has been designated for litigation," and they will not refer any undesignated case if reconsideration by the Appeals Office "is not in the interest of sound tax administration."[78]

In August 2020, the IRS issued a memorandum containing guidance about designation of cases for litigation.[79] It suggested that some tax issues are susceptible to recurring compliance challenges, administrative guidance does not effectively address such issues, and audit personnel may request designation "where sound tax administration is best served" by forcing the Tax Court to act as the heavy.[80] Importantly, the memorandum provides various examples of when "sound tax administration is best served by establishing judicial precedent," including situations where revoking access to the Appeals Office supposedly would (i) "stem the proliferation of abusive tax shelters or other significant non-compliance," (ii) reduce future compliance and dispute costs, for the IRS and other taxpayers, (iii) resolve issues where published IRS guidance has not resulted in what the IRS considers compliance, and/or (iv) obtain clarity where "there is a wide divergence between the IRS and taxpayer viewpoints on the law."[81] Consistent with the memorandum, the IRS has started depriving some partnerships of access to the Appeals Office, without formally designating SCETs for litigation. At least one partnership has challenged this IRS tactic in court.[82]

Wrong #18—Using the Same Data in Different Contexts

Section 6103 generally requires the IRS to safeguard the confidentiality of "returns" and "return information."[83] There are few exceptions to this broad prohibition against disclosure.[84]

The IRS issued a series of notices over the years about disclosure of data in the situations involving "tax shelter

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77 Rev. Proc. 2016-22, section 3.01 and section 3.05.

78 Rev. Proc. 2016-22, section 3.03.

79 IR-2020-188 (8/24/2020) (attaching a memorandum from the IRS Deputy Commissioner for Services and Enforcement, dated 8/24/2020, called "Interim Guidance on Designation of Cases for Litigation").

80 *Id.*

81 *Id.*

82 *Hancock County Land Acquisitions, LLC v. United States*, Case No. 1:20-cv-3096-AT, DC Ga., Complaint, dated 7/25/2020; Parillo, "DOJ: Taxpayer First Act Didn't Create Absolute Right to Appeals," 2020 Tax Notes Today Federal 224-8 (11/19/2020) (explaining and attaching Motion to Dismiss and Memorandum of Law in Support of Motion to Dismiss by the DOJ).

83 Section 6103(a); Section 6103(b)(1); Section 6103(b)(2)(D).

84 Section 6103(h)(1); Section 6103(h)(4)(A).; Section 6103(h)(4)(B); Section 6103(h)(4)(C); Section 6103(l)(4)(B).

85 IRS Chief Counsel Directive 2006-003 (10/25/2005).

86 *Id.*, section 1.

87 IRS Chief Counsel Directive 2006-006 (11/22/2005).

88 IRS Chief Counsel Directive 2020-008 (9/8/2020); *see also* Parillo, "IRS Explains Contours of Disclosing Syndicated Easement Info," 2020 Tax Notes Today Federal 176-2 (9/11/2020).

89 Notably, the First CCD, Second CCD, and Third CCD only focus on efforts by the IRS to circumvent the general non-disclosure rules in Section 6103. They are silent on a critical issue, which is how, precisely, the IRS plans to overcome a long list of prohibitions in the Federal Rules of Evidence and the Tax Court Rules of Practice and Procedure against introducing evidence that is irrelevant, unduly prejudicial, confusing, misleading, un-

matters." The IRS started with Chief Counsel Directive 2006-003 ("First CCD").[85] Its purpose was to provide guidance regarding disclosure of data gathered by the IRS in civil examinations and other investigations of "tax shelter promoters" and "tax shelter investors."[86] The IRS provided examples in the First CCD in support of its position that it can disclose, in separate proceedings, information about different taxpayers who participated in substantially similar transactions involving the same promoter. The IRS next issued Chief Counsel Directive 2006-006 ("Second CCD"), whose sole function was to supply additional definitions and examples of the principles described previously in the First CCD.[87] Most recently, in September 2020, the IRS released Chief Counsel Directive 2020-008 ("Third CCD").[88] Its purpose was to add five more examples, *all of which pertain to SCETs.*

The First CCD, Second CCD, and recent Third CCD reveal that the IRS intends to cross-reference and multitask to the greatest extent possible in SCET cases, (i) presenting evidence obtained during different administrative and judicial proceedings, (ii) about multiple unrelated partners, their relationships with alleged promoters, and pre-donation actions by various persons, (iii) in a manner that supposedly does not violate the non-disclosure rules.[89]

Wrong #19—Punishing Prior Advisors

During the early stages of an audit, Revenue Agents generally issue a broad IDR seeking a large number of documents, including copies of the relevant Forms 1065, Forms 8886, Forms 8918, tax or legal opinions issued to the partnership, Private Placement Memoranda, and other offering materials. If the professionals representing the partnership during the audit appear on any of these pre-easement-donation documents, the IRS often issues a follow-up IDR asking the following questions: Did the professionals advise the partnership or any partners about the planning or execution of the SCET? Did they participate in any manner with the marketing or promotion of the SCET? Did they issue any tax or legal opinions?

The IRS is making these inquiries for several reasons. First, the IRS is probing to determine if there is a "conflict of interest," which might render the representative ineligible to participate in the audit.[90] Second, the IRS is seeking possible ways to argue that the attorney-client privilege or FATP never existed or has been waived, such that the IRS can access otherwise confidential communications.[91] Third, the IRS is playing the long game, trying to create a record to support a later Motion to Disqualify Opposing Counsel during the Tax Court proceeding allegedly because of an insurmountable conflict of interest or because the representative "is likely to be a necessary witness."[92]

Wrong #20—Challenging Ability to Make Qualified Offers

Section 7430 generally provides that the "prevailing party" in any administrative proceeding before the IRS, or in any Tax Court litigation against the IRS, may be awarded reasonable costs.[93] There is a lesser known, but often more effective, way for taxpayers to obligate the IRS to pay: making a "qualified offer." A taxpayer is treated as the "prevailing party" if the taxpayer's liability, as ultimately determined by a court, is the same as or less than it would have been if the IRS had accepted the qualified offer.[94] Stated differently, if the IRS ignores or rejects a qualified offer, the case goes to trial, and the court rules that the taxpayer's liability is equal to or below the qualified offer, then the IRS ordinarily must reimburse the taxpayer's reasonable administrative and/or litigation costs.

Only two cases have addressed whether partnerships subject to the TEFRA proceedings, like most partnerships engaged in SCETs, are able to make qualified offers.[95] Just one of these cases yielded a decision with precedential value, and it explained that TEFRA partnerships *are entitled* to file qualified offers.[96] Despite the fact that both the Court of Federal Claims and the Federal Circuit Court of Appeals have supported the notion that partnerships can make qualified offers, and despite the fact that the contrary decisions by the Tax Court were issued in the form of non-precedential "Orders," the IRS seems entrenched in its traditional position, arguing as recently as September 2020, in a pending Tax Court case, that TEFRA partnerships are ineligible to file qualified offers, period.[97]

Wrong #21—Trying to Consolidate Multiple Cases

Logic dictates that donations of conservation easements are all unique because they involve distinct properties, in mul-

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founded, unauthenticated, privileged, hearsay, limited in scope, etc. For information about potential evidentiary challenges for the IRS, *see* Larson, "Tax Evidence: A Primer on the Federal Rules of Evidence As Applied by the Tax Court," 53 Tax Law 181 (1999); Larson, "Tax Evidence II: A Primer on the Federal Rules of Evidence As Applied by the Tax Court," 57 Tax Law 371 (2004); Larson, "Tax Evidence III: A Primer on the Federal Rules of Evidence As Applied by the Tax Court," 62 Tax Law 555 (2009); Larson, "A Practitioner's Guide to Tax Evidence, Second Edition," American Bar Association Section of Taxation (2017).

90 Section 10.29(a) of Treasury Department Circular 230.

91 The typical IDR states the following in this regard: "If any responsive documents are withheld from production, provide a proper privilege log setting forth on a document-by-document basis (a) the specific grounds upon which you rely for withholding the document; (b) the date appearing on the document or the date the document was prepared if it has no date; (c) a description, the subject matter, a summary of the content, and the number of pages (or if electronic, the size) of the document withheld; (d) the identity of the author or preparer of the document; (e) the identity of the person to whom the document was addressed or directed or for whom it was prepared; (f) the identity of all persons who received the document or a copy thereof. If you claim common law or statutory privileges as the grounds for withholding the document, specify the type of privileges claimed and the legal and factual bases for the privileges."

92 Tax Court Rules & Procedures 24(g)(1); *See also* American Bar Associate Model Rules of Professional Conduct 1.7 and 1.8; *See also* Tax Court Rules & Procedures 201(b) (stating that the Tax Court can require a practitioner "to furnish a statement, under oath, of the terms and circumstances of his or her employment in any case."); Tax Court Rules & Procedures 24(g)(2)(A).

93 Section 7430(a).

94 Section 7430(c)(4)(E)(i); Reg. 301.7430-7(a); Reg. 301.7430-7(b)(1).

95 BASR Partnership v. United States, 130 Fed. Cl. 286, 119 AFTR2d 2017-614 (Cl. Ct. 2017); BASR Partnership v. United States, 915 F.3d 771 (CA-F.C., 2019); Hurford Investments No. 2, Ltd., Docket No. 23017-11, Tax Court Order, 12/21/18; Hurford Investments No. 2. Ltd., Tax Court Docket No. 23017-11, Order dated 9/11/2019.

96 *See* Sheppard, "Partnerships, Qualified Offers, and Conservation Easement Disputes: Analyzing Problems with the IRS's Positions, Now and Later," __ Journal of Tax Practice & Procedure ___ (2020).

tiple locations, with varying conservation purposes, with particular HBUs, with different partners, etc. The IRS has recently started challenging this stance, arguing that many SCETs are so similar in fundamental ways that the Tax Court should deprive the partnerships of separate trials and their chance to have justice focused on just one situation. To the disappointment of taxpayers, the Tax Court has accepted the IRS's reasoning in at least one recent case.

Specifically, in *Green Valley Investors, LLC*, the IRS filed a Motion with the Tax Court, asking it to consolidate four different cases for all purposes. The partnerships opposed the Motion, of course, contending that the four cases are factually and legally different and, thus, should be considered individually by the Tax Court. Siding with the IRS, the Tax Court agreed to consolidate the cases on the following grounds: (i) all partnerships were organized in the same state; (ii) the TMP is the same in all cases; (iii) the same attorneys represent all partnerships; (iv) all partnerships are seeking trials in the same city; (v) all cases involve SCETs; (vi) the legal issues in each case are the same; (vii) the conservation easements were all donated to the same land trust; (viii) all four properties are located in the same county; and (ix) the partnerships and the IRS intend to call many of the same witnesses and introduce much of the same documentary evidence.[98]

Wrong #22—Refusal to Provide Sample Deed Language

The IRS has taken many actions, yet it seemingly refuses to budge on others. For example, various parties have asked the IRS to issue "model language" to utilize in their Deeds to avoid triggering unintentional "technical" flaws, unrelated to conservation purposes, and unrelated to the value of the donation.[99] One such party is the National Taxpayer Advocate, whose recent reports to Congress underscore that the IRS has engaged in aggressive enforcement actions, resulting in hundreds of partnerships filing Petitions with the Tax Court in a short period.[100] Below are the National Taxpayer Advocate's recommendations:

> Develop and publish guidance to provide safe harbors and/or sample easement provisions to provide taxpayers with examples of how they may construct a conservation easement deed that satisfies the statutory requirements and prevent unnecessary litigation.[101]
>
> Develop and publish additional guidance that contains sample easement provisions to assist taxpayers in drafting deeds that satisfy the statutory requirements for qualified conservation contributions, particularly the perpetuity requirements for those conservation easements that incentivize land preservation for future generations.[102]

The official response by the IRS to the preceding suggestions is that the IRS supposedly shares the goal of preventing unnecessary litigation by making it easier for taxpayers to prepare Deeds that comply with applicable law and regulations, the IRS is in the process of drafting sample clauses for taxpayers, but the IRS has not yet published any guidance because of "other workload priorities."[103]

Wrong #23—Advancing Criminal Investigations

The IRS has announced for several years that the Criminal Investigation Division would be running its own, separate investigations related to SCETs.[104] Consistent with such proclamations, in December 2020, the government publicized guilty pleas by two accountants involved with SCETs, labeling them "the first of many criminal tax charges."[105] In a similar vein, high-ranking DOJ tax attorneys announced at conferences that, in the context of SCETs, they intend to assert the crime-fraud exception to the attorney-client privilege. This essentially means that they will seek access to communications between attorneys and clients, which normally would be sacrosanct, based on allegations that the attorneys supplied advice in furtherance of an illegal or fraudulent activity.[106]

Wrong #24—Criminal Penalties for Ignoring Summonses

The most common tool used by the IRS during an audit to gather documents and data is the IDR.[107] The IRS has other avenues, too, including the issuance of Summonses. If the recipient of a Summons fails to respond adequately, the IRS has several options, the most common of which is asking the district court to enforce the Summons.[108] In the context of SCETs, though, the government has taken an

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[97] Little Horse Creek Property, LLC, Tax Court Docket No. 7421-19.

[98] Green Valley Investors, LLC, Tax Court Docket Nos. 17379-19, 17380-19, 17381-19, and 17382-19. Order dated 11/10/2020.

[99] Parillo. "Yellen and Rettig Asked to Clarify Easement Rules," 2021 Tax Notes Today Federal 15-7 (1/25/2021) (noting that various groups have asked the IRS to issue "model language to avoid unnecessary litigation.")

[100] National Taxpayer Advocate. Annual Report to Congress (2020), pp. 216-219.

[101] *Id.*, p. 203.

[102] *Id.*, p. 219.

[103] National Taxpayer Advocate. Annual Report to Congress (2019), appendix 1, pp. 194-195.

[104] Richman, "Multiple Divisions Coming for Syndicated Conservation Easements," 2019 Tax Notes Today Federal 220-3 (11/13/2019); IRS Information Release 2019-182 (11/12/2019); Richman, "IRS Is Talking to Prosecutors about Conservation Easements," 2020 Tax Notes Today Federal 223-6 (11/18/2020).

[105] Richman, "IRS Predicts More Criminal Tax Charges for Conservation Easements," Tax Notes Document Number 2021-1957 (1/19/2021); Parillo, "DOJ Nabs Guilty Pleas in First Criminal Easement Case," 2020 Tax Notes Today Federal 245-9 (12/22/2020); U.S. Dep't of Justice, Press Release No. 20-1381, "Atlanta Tax Professionals Plead Guilty to Promoting Syndicated Conservation Easement Tax Scheme Involving More than $1.2 Billion in Fraudulent Charitable Deductions," 12/21/2020.

[106] Parillo. "DOJ Tax Division to Make Strategic Use of Crime-Fraud Exception." 2020 Tax Notes Today Federal 189-8 (9/30/2020).

[107] Section 7602(a).

[108] Section 7604.

[109] Section 7210. *See also* Section 7203 (establishing a criminal penalty for willfully failing to supply information to the IRS).

[110] Richman. "Prosecutor is Looking for More Tax Summons Criminal Charges," 2021 Tax Notes Today Federal 18-4 (1/28/2021).

[111] IRM § 5.17.6.21 (12/11/2007).

[112] IRM § 5.17.6.21 (12/11/2007) (emphasis added).

[113] IRS Chief Counsel Advisory 200206054 (2001), footnote 7; United States v. Becker, 259 F.2d 869 (CA-2, 1958) (upholding criminal prosecution under Section 7210 where the taxpayer willfully and knowingly refused to produce certain materials demanded in a proper Summons).

extreme position. Specifically, it has threatened to *criminally* charge those whose fail to obey a Summons.

An obscure tax provision states that any person to whom the IRS issues a Summons and who fails to appear to testify and/or provide the requested materials can be convicted of a crime, fined as much as $1,000, and imprisoned for up to one year.[109] One DOJ tax attorney recently announced that this instrument is "underused," often "stacked" with other applicable penalties, does not require "willful" actions or inactions by the person charged, and should be "taken to heart" by the public.[110]

These type of admonitions, focused on SCETs, are noteworthy because they directly contradict IRS guidance to its own personnel. For instance, the IRS acknowledges that potential criminal prosecution is a "powerful tool" to compel compliance, but cautions that using it often backfires.[111] According to the Internal Revenue Manual, a criminal action "does *not* accomplish the primary purpose of the Summons, namely, obtaining the needed information, because any proceedings to enforce the Summons would be held in abeyance pending the outcome of the criminal proceedings."[112] Moreover, the IRS has stated that criminal charges should only be raised after attempts at civil enforcement fail and that recommendations for prosecution are rare.[113] This leads to the question of whether those at the DOJ making menacing pronouncements are unaware of the government's official stance on the limited benefit of criminal charges or they simply care more about trying to bully taxpayers than actually gathering the relevant data.

Wrong #25—Seeking Additional Disclosure Statements

Taxpayers generally file Form 8275, *Disclosure Statement*, to disclose to the IRS items or positions, not otherwise adequately disclosed on tax returns, in order to avoid certain penalties, such as those for having a "substantial understatement of income tax" or for lacking economic substance. In situations where taxpayers are taking a position that is contrary to an existing regulation, they file a Form 8275-R, *Regulation Disclosure Statement.*

A comparison of "undisclosed" and "disclosed" positions on a tax return illustrates the issues. For undisclosed transactions (that are not tax shelters), the general rule is that if there is "substantial authority" for the tax treatment of an item, then the item is treated as if it were shown properly on the return. In other words, the item is *not* included as part of the tax understatement.[114] In the case of disclosed transactions (that are not tax shelters), the rule is that the item in question is not counted as part of the tax understatement if (i) the relevant facts are adequately disclosed, either on the tax return itself or on a Form 8275 or Form 8275-R attached to such return, (ii) there is a "reasonable basis" for the position, and (iii) the taxpayer maintains adequate books and records about the position.[115]

The IRS contends that an SCET is a "tax shelter" for these purposes, such that filing of a Form 8275 or Form 8275-R would not help taxpayers anyway. Nonetheless, in an effort to eliminate possible defenses to penalties for donations supposedly creating a "substantial understatement of income tax" or lacking economic substance, the IRS now regularly asks in its IDRs whether the partnership disclosed the SCET to the IRS on Form 8275 or Form 8275-R, in addition to on Form 1065, Form 8283, qualified appraisal, Form 8886, and Form 8918.[116]

Wrong #26—Raising Theories Beyond the Tax Code

The IRS has been threatening for years to raise "novel" theories for challenging charitable tax deductions stemming from SCETs. For example, the IRS announced in Notice 2017-10 issued in December 2016 that it might attack SCETs based on the partnership anti-abuse rules, economic substance doctrine, and/or other unspecified rules and doctrines.[117]

Likewise, in the Complaint filed by the DOJ in December 2018 seeking an injunction against various persons involved with SCETs, the DOJ alleged that the partnerships were not true partnerships for federal tax purposes, they existed solely as a conduit to "sell" tax deductions, they were "shams," and they "lacked economic substance."[118]

More recently, in the revised edition of the ATG published in late 2020, the IRS encouraged its personnel to consider launching new arguments, grounded in the partnership anti-abuse rules and various judicial doctrines, including bona fide partner and partnership, sub-

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[114] Section 6662(d)(2)(B)(i); Reg. 1.6662-4(d)(1).

[115] Section 6662(d)(2)(B)(ii); Reg. 1.6662-4(e)(1); Reg. 1.6662-4(f)(1); Reg. 1.6662-4(f)(2); Rev. Proc. 2008-14.

[116] Various sample IDRs are on file with the author.

[117] Notice 2017-10, section 1.

[118] United States v. Zak, Clark, EcoVest Capital Inc., Solon, McCullough, and Teal, Case No. 1:18-cv-05774, D.C. Ga, Complaint filed 12/18/2018, p. 47.

[119] IRS, *Conservation Easement Audit Techniques Guide*. IRS Publication 5464 (rev. 11-2020), pp. 69-72.

[120] Richman. "Future Easement Charges Could Pivot on Economic Substance Questions," 2020 Tax Notes Today Federal 19-4 (1/29/2021).

[121] Coppinger, "Legislative Direction and Tax Compliance: A Tax Policy and Philosophy at Odds," 6 Taxes—The Tax Magazine 710 (1983).

[122] The IRS has made similar arguments about risk and partner status in the past. *See* Virginia Historic Tax Credit Fund, TC 2009-295.

[123] *See* TD 8875 (3/2/2000); TD 8876 (3/2/2000); TD 8877 (3/2/2000); TD 8896 (8/16/2000); TD 8961 (8/7/2001); TD 9000 (6/18/2002); TD 9017 (10/22/2002); TD 9018 (10/22/2002); TD 9046 (3/4/2003); TD 9108 (12/30/2003); TD 9350 (8/3/2007).

[124] TD 8877 (3/2/2000); REG-103735-00.

[125] TD 8877 (3/2/2000), Preamble.

[126] *Id.*; Temp. Reg. 1.6011-4T(b)(3)(B).

[127] TD 9046 (3/4/2003).

[128] *Id.*, Preamble; Reg. 1.6011-4(b)(4)(i); Reg. 1.6011-4(b)(4)(ii).

[129] Rev. Proc. 2019-3, section 4.02(1). This is an issue on which the IRS "ordinarily will not rule."

[130] Id., section 3.01(90).

[131] Id., section 3.02(1).

[132] Id., section 3.02(2).

[133] Id., section 3.02(5).

[134] Id., section 4.02(5). This is an issue on which the IRS "ordinarily will not rule."

[135] Historic Boardwalk Hall, LLC, 694 F.3d 425 (CA-3, 2012), rev'g 136 TC 1 (2011).

[136] *Id.*

[137] Rev. Proc. 2014-12, section 4.05.

[138] *Id.*, section 4.05(2)(a).

[139] *Id.*, section 4.05(2)(a) (emphasis added).

[140] Rev. Proc. 2020-12, section 1.

[141] Id., section 4.08(1).

[142] *Id.* (emphasis added).

[143] Section 7602(a); Reg. 301.7602-1(a).

[144] U.S. Senate, Committee on Finance. Internal Revenue Service Restructuring and Reform Act

stance-over-form, step transaction, and economic substance.[119] Senior IRS officials also speculated that "future cases could hinge on the whole picture of transactions misrepresenting their economic substance."[120]

Wrong #27—Attacking Tax Insurance

In an effort to achieve an acceptable level of certainty, some partnerships that participated in SCETs have obtained various types of protection. Among them is a product that goes by several names, such as tax gap, tax result, tax protection, or tax indemnity insurance ("Tax Result Insurance"). This is not new; Tax Result Insurance has been around for nearly four decades since the early 1980s.[121] However, the IRS has only recently started challenging it, especially when it comes to SCETs.

The IRS regularly enquires about Tax Result Insurance during audits nowadays, sending IDRs seeking copies of all agreements, guarantees, representations, or assurances relating to tax benefits anticipated from the SCET, including arrangements to reimburse or indemnify the partnership or its partners in the event that the IRS and/or the courts deny such benefits. The IRS is trying to beef up the following syllogism: The bedrock of a partnership is the existence of downside and upside risk. Tax Result Insurance somehow removes risk. Therefore, insured partnerships that engaged in SCETs are not "partnerships" and they cannot benefit from tax deductions.[122] The problem for the IRS is that this line of reasoning overlooks several inconvenient realities, a few of which are discussed below.

The first reality is that the IRS previously analyzed Tax Result Insurance and essentially concluded that it is not problematic. The IRS published several versions of regulations years ago in connection with reportable transactions.[123] The first set of proposed regulations, released in 2000, focused on disclosure statements for certain taxpayers.[124] The Preamble stated that the IRS was concerned about the proliferation of tax shelters, and the regulations were designed to give the IRS early notification of transactions that "may be indicative of such tax shelter activity."[125] The regulations identified various transactions that warranted further scrutiny, including those that offered some type of "contractual protection" like insurance. The IRS defined the concept as follows:

> The taxpayer has obtained or been provided with contractual protection against the possibility that part or all of the intended tax benefits from the transaction will not be sustained, including, but not limited to . . . insurance protection with respect to the tax treatment of the transaction, or a tax indemnity or similar agreement (other than a customary indemnity provided by a principal to the transaction that did not participate in the promotion of the transaction to the taxpayer).[126]

The IRS issued final regulations in 2003.[127] In doing so, the IRS indicated that, after considering public input, it decided to *remove* Tax Result Insurance from the concept of "contractual protection."[128] Stated differently, the IRS decided that the existence of insurance does not make something a "tax shelter."

The second reality is that taxpayers cannot obtain "insurance" from the IRS. Those engaged in organizing partnerships that might donate conservation easements desire certainty through manners other than purchasing Tax Result Insurance. The problem, however, is that the IRS has essentially made this impossible. Many taxpayers would like to pro-actively approach, disclose all relevant data to, and request "insurance" directly from the IRS, in the form of a positive private letter ruling ("PLR"). The rub is that the IRS outright refuses to grant PLRs on many issues fundamental to easement donations, thereby forcing taxpayers to turn elsewhere, such as to companies offering Tax Result Insurance. Below is a list of the items on which the IRS will *not* issue a PLR, many of which, remarkably, are identical to the items the IRS is attacking in connection with SCETs:

- "Any matter in which the determination requested is primarily one of fact, *e.g.*, market value of property . . ."[129]
- "Matters relating to the validity of a partnership or whether a person is a partner in a partnership."[130]
- "Whether the economic substance doctrine is relevant to any transaction or whether any transaction complies with the requirements of [Section] 7701(o)."[131]
- "The results of transactions that lack a bona fide business purpose or have as their principal purpose the reduction of federal taxes."[132]
- "Whether . . . reasonable cause, due diligence, good faith, clear and convincing evidence, or other similar terms that require a factual determination exist."[133]
- "Any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of a trade or business."[134]

The third reality is that the IRS previously issued two Revenue Procedures expressly blessing Tax Result Insurance. In *Historic Boardwalk Hall*, the Court of Appeals held that an investor/member was not a bona fide partner for federal income tax purposes, and thus was not entitled to receive an allocation of historic rehabilitation credits from the partnership.[135] The primary reason for this decision was that the investor/member had the right to a guaranteed reimbursement of its investment if it did not receive the anticipated tax credits. This, concluded the Court of Appeals, meant that the investor/member did not incur any entrepreneurial risks and did not adequately participate in the financial upside or downside of the business, such that it was not a "partner."[136]

In response to the decision in *Historic Boardwalk Hall,* the IRS issued Rev. Proc. 2014-12, which established a "safe harbor" for structuring historic rehabilitation credit transactions. Rev. Proc. 2014-12 describes certain "impermissible guarantees."[137] These include a restriction against any person involved in the transaction guaranteeing or otherwise insuring the ability of a partner to claim the credits, the cash equivalent of such credits, or the repayment of any portion of the partner's contribution to the partnership due to the inability to claim the credits, if the IRS were to challenge the transactional structure of the partnership.[138] Importantly, Rev. Proc. 2014-12 ex-

pressly states that this "does *not* prohibit the [partner] from procuring insurance *from persons not involved with* the rehabilitation or the partnership."[139] In other words, the IRS concluded that obtaining Tax Result Insurance from an independent insurer is not problematic, at least in the historic rehabilitation tax credit context.

A few years later, the IRS issued Rev. Proc. 2020-12, which created a "safe harbor" for partnerships allocating credits for carbon dioxide sequestration.[140] Rev. Proc. 2020-12 features various warnings, including that no person involved in any part of the company that generates the tax credits can guarantee or otherwise insure, directly or indirectly, an investor's ability to claim the credits, the cash equivalent of the credits, or a repayment of any portion of the investor's contribution because of an IRS challenge.[141] However, Rev. Proc. 2020-12 expressly states that such restrictions against guaranteed results "does *not* prohibit the investor from procuring insurance, including recapture insurance, *from persons not related to*" the project developer, another investor/partner, the company emitting the carbon dioxide, or a party purchasing qualified carbon dioxide.[142]

Wrong #28—Making Inappropriate Third Party Contacts

Getting audited is bad enough, but having the IRS tell friends, colleagues, employers, clients and others about it might be far worse. The mere fact that the IRS is auditing someone, no matter how routine it might be, can cause serious reputational, business, and financial damage to the person under scrutiny.

The IRS enjoys broad powers in doing its job. For instance, for purposes of auditing any return, determining the liability of a taxpayer, and collecting such liability, the IRS can examine any books, records, or other data that might be relevant or material. It can also issue Summonses to taxpayers; persons in possession, custody, or control of pertinent data; and "any other person that the [IRS] may deem proper."[143] The IRS often seeks information from persons *other than* the taxpayer during the audit process; this is called making third party contacts ("TPCs").

Granting any organization, including the IRS, broad powers often results in abuse. This is what came to light in the late 1990s, which led Congress to enact the IRS Restructuring and Reform Act. That law introduced limitations on TPCs. The legislative history contained the following rationale for imposing new restrictions on Revenue Agents conducting audits.

> The [Senate Finance] Committee believes that taxpayers should be notified *before* the IRS contacts third parties regarding examination and collection activities with respect to the taxpayer. Such contacts may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community. Accordingly, the [Senate Finance] Committee believes that *taxpayers should have the opportunity to resolve issues and volunteer information before the IRS contacts third parties.*[144]

Consistent with the legislative history, the IRM emphasizes that Revenue Agents should not utilize TPCs as a primary auditing tool, but rather they should first grant the taxpayer a chance to supply the relevant data. The IRM makes this clear in several places:

> [Revenue Agents are directed] to give notice to taxpayers, allowing them an opportunity to provide the information, *before* disclosing to a third party that the taxpayer is the subject of an [IRS] action.[145]

> A [TPC] is made when the taxpayer is unable or unwilling to provide the necessary information or when the examiner needs to verify information provided. The examiner should generally request the information [through an IDR] *before* making a TPC.[146]

> The intent behind this statute is to provide the taxpayer, in most cases, with the opportunity to produce the information and documents requested *before* the IRS must obtain the information from third parties.[147]

Section 7602 lacks an express remedy for aggrieved taxpayers; that is, it does not contain a specific procedure for a taxpayer to challenge the IRS in situations where it violates the general pre-contact notice duties. Consequently, litigation in this area is sparse. The pertinent cases primarily focus on a taxpayer's ability to "quash," or nullify, a Summons issued by the IRS to a third party, when the IRS has not followed all the rules. One such case, *J.B. and P.B. v. United States*, generated several holdings that echo the language in the legislative history and IRM described above.[148] The Court of Appeals in that case set a high standard in terms of what type of pre-contact notice the IRS must give taxpayers. It stated that the IRS must provide "reasonable notice in advance," defined as follows:

> [N]otice reasonably calculated, under all the relevant circumstances, to apprise interested parties of the possibility that the IRS may contact third parties, and that *affords interested parties a meaningful opportunity to resolve issues and volunteer information before third-*

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of 1998, 105th Congress, 2d Sess., Rep't. No. 105-174 (4/22/1998), p. 77.

[145] IRM § 4.11.57.1 (5/26/2017) (emphasis added).

[146] IRM § 4.11.57.2 (5/26/2017) (emphasis added).

[147] *Id.* (emphasis added).

[148] J.B. and P.B. v. United States, No. 16-15999, opinion (CA-9, 2/26/2019).

[149] *Id.* (emphasis added).

[150] Letter from Revenue Agent J. Whittington Tindall dated 3/18/2021; Letter from Revenue Agent Justin L. Yarnell dated 2/25/2021; Letter from Revenue Agent Susan Giangarra dated 5/17/2021. All letters are on file with the author.

[151] National Taxpayer Advocate, Annual Report to Congress (2019), p. 203.

[152] Parillo, "Conservation Easement Safe Harbor May Allow Compromise." 2020 Tax Notes Today Federal 88-7 (5/6/2020); National Taxpayer Advocate, Annual Report to Congress (2020), pp. 216-219; *See, e.g.*, Rev. Proc. 2014-12 and Rev. Proc. 2020-12.

[153] Rev. Proc. 96-15; IRS Publication 5497, *Photographic Requirements for Art, Antiques, Decorative Arts & Other Cultural Properties Reviewed by Art Appraisal Services and the Commissioner's Art Advisory Board*; IRM § 4.48. 2—Valuation Assistance for Cases Involving Works of Art; IRS Publication 5392, T*he Art Advisory Panel of the Commissioner of Internal Revenue Annual Summary Report for Fiscal Year 2019* (rev. 4-2020).

[154] Jay, "Perpetual Conservation Easements in Wonderland, Part 2" Tax Notes Federal, Volume 171, May 2021, pp. 754-756.

party contacts are made [by the IRS].[149]

Despite the unambiguous guidance about the limited use and timing of TPCs from Congress, IRS publications, and the courts, certain Revenue Agents auditing SCETs have apparently decided to ignore it. Specifically, in response to written requests from partnerships for data about TPCs, some Revenue Agents have (i) refused to respond on grounds that taxpayers supposedly can only make requests every 90 days, without offering any tangible support for such restriction, (ii) suggested that a request is void if it asks for any information beyond just the names of those receiving TPCs, (iii) indicated, contrary to all the sources described above, that the IRS does not need to first seek data from the partnership before making TPCs, and/or (iv) threatened to refer representatives of the partnerships to the Office of Professional Responsibility for doing nothing more than seeking data about TPCs.[150]

Wrong #29—Refusal to Implement Improvements

Various parties with different perspectives have offered suggestions to the IRS to improve the situation. For instance, as explained above, the National Taxpayer Advocate has repeatedly asked the IRS to release "model language" for taxpayers to use in their Deeds to avoid fatal "technical" flaws unrelated to conservation, value, or intent.[151] It has also suggested that the IRS develop a "safer harbor" and publish it as a Revenue Procedure, as the IRS historically has done in many other contexts.[152] Others have floated the idea of forming a specialized appraisal board to avoid valuation disputes concerning SCETs, similar to the one that exists for donations of art.[153] Finally, others have recommended that the IRS produce a compliance checklist for taxpayers to use and attach to their tax returns, broadly interpret the concept of "substantial compliance" with the law, and allow taxpayers a reasonable period to cure any technical defects after notice.[154] The IRS has implemented *none* of these ideas.

Conclusion

Congress, taxpayers, conservationists, the IRS, and others have strong, and often conflicting, feelings about SCETs. Differences of opinion are fine, and *normal* scrutiny by the IRS is appropriate, too. What this article explains, though, is that many of the aggressive procedures that the IRS is implementing now in the SCET context are far from ordinary and could have negative ramifications for *all* taxpayers in the future. The IRS tries to demonize SCETs, which is understandable given its role as top tax enforcer. This article offers a counterbalance, suggesting that those concerned about taxpayer rights, separation of powers between the three branches of government, environmental protection, and other large-scale matters should contemplate whether 29 "wrongs" by the IRS are really achieving a "right."