Extreme IRS Actions Fortify Taxpayer Disclosure Defenses in Conservation Easement Disputes

HALE E. SHEPPARD, ESQ.

During examinations and the Tax Court pre-trial discovery process, the IRS is aggressively seeking documents prepared in connection with the potential donation of conservation easements. Taxpayers have various defenses to forced disclosure of documents by the IRS, including the work-product doctrine.

Introduction

Recurrent announcements by the Internal Revenue Service ("IRS") that it plans to examine *all* "syndicated" conservation easement donations, argue that *all* related tax deductions should be $0, and litigate all cases before the Tax Court might dissuade certain taxpayers from participating. However, these words and actions could also create unintended consequences for the IRS, particularly when it comes to what type of documents the IRS can forcibly obtain from taxpayers, their representatives, and others during a tax dispute.

This article describes data-gathering tools that the IRS often uses during audits and tax litigation, the aggressive manner in which the IRS is employing such mechanisms in conservation easement clashes, key court decisions analyzing the ability of taxpayers to protect documents under the work-product doctrine, and events leading taxpayers to believe, from inception, that disputes with the IRS are a virtual certainty. This article then concludes with a list of realities, which, taken together, undermine the IRS's cause.

Filing Returns and Supporting Them

Any person liable for taxes normally must file a complete, accurate and timely return, using the forms issued by the

Hale E. Sheppard, Esq. (B.S., M.A., J.D., LL.M., LL.M.T.) is a Shareholder in the Tax Controversy & Litigation Section of Chamberlain Hrdlicka in Atlanta. Hale specializes in tax audits, tax appeals, tax litigation, and international tax. You can reach Hale by phone at (404) 658-5441 or by e-mail at hale.sheppard@chamberlainlaw.com.

IRS.[1] Taxpayers also must retain records in case the IRS decides to examine them.[2] In terms of accessibility and duration, taxpayers need to ensure that their records are kept "at all times available for inspection" by the IRS and preserve them for as long as it "may become material in the administration of any internal revenue law."[3] The IRS sometimes checks the records, both during examinations and, later, before Tax Court litigation.

Data-Gathering Tools during Examinations

The IRS enjoys extensive powers in doing its job. It can do several things for purposes of examining returns, preparing returns when taxpayers fail to do so, determining liabilities of taxpayers, and collecting them. For starters, the IRS can examine any books, records or other data that might be relevant or material. Its preferred method for carrying out examinations is to issue an Information Document Request ("IDR") to taxpayers.[4] Taxpayers might not supply all items identified in an IDR. One motive for declining to surrender certain data to the IRS is that it is protected from disclosure under one or more privileges, such as the work-product doctrine. The Revenue Agent has several options if a taxpayer refuses to submit the requested materials. The most common is issuing a Summons.

The power to gather data via a Summons is broad. The IRS has the ability to send a Summons not only to the taxpayer under examination, but also to any person required to perform tax-related acts, any person in possession, custody or control of pertinent data, or "any other person that the [IRS] may deem proper."[5] Moreover, when the IRS encounters resistance to a Summons, it can employ several tools, including asking the court to enforce the Summons or seek criminal sanctions against the intransigent party.[6] For these reasons, the Summons has been labeled the "principal coercive mechanism" available to the IRS, and it constitutes the tacit threat behind all IDRs, requests for interviews, and other data-gathering mechanisms used during an audit.[7]

The IRS is aggressively seeking data during examinations of conservation easement donations. One early sign was when the IRS issued a legal memo in February 2020 featuring major changes to audits of "listed transactions," including certain easements.[8] The IDR enforcement process traditionally featured four graduated steps. Revenue Agents first issued an IDR, followed by a Delinquency Notice, then a Pre-Summons Letter, and, ultimately, a Summons.[9] This multi-step process, which stemmed from the idea that the audit process should be cooperative and court intervention should be a last resort, was "mandatory and [had] no exceptions."[10] Because of the recent memo, however, the prior obligatory process is no longer required when dealing with conservation easements. Revenue Agents now adhere to swifter procedures.[11]

Doubling down on this mindset, the IRS issued another legal memo in November 2020.[12] To counter alleged delays and other impediments to audits, the memo instructs Revenue Agents to "use all available administrative tools," promptly issue Summonses, and if full compliance by taxpayers and others does not ensue, initiate Summons enforcement in the courts.[13]

Data-Gathering Tools before Trial

In situations where the taxpayers are unable to resolve tax disputes during an examination or subsequent review by the Appeals Office, the IRS ultimately issues a Notice of Deficiency, Notice of Final Partnership Administrative Proceeding ("FPAA"), or other type of final notice. An uncontested final notice generally is deemed accurate. This means that the IRS can "assess" the amounts shown (*i.e.*, convert them from a proposed debt into an actual debt) and then start taking collection actions. Taxpayers ordinarily want to avoid this outcome, so they file a Petition with the Tax Court.[14]

After taxpayers and the IRS attorneys have submitted their initial pleadings with the Tax Court, they are free to start the pre-trial discovery process. The Tax Court requires that the parties "informally" exchange as much data as possible *before* employing "formal" discovery tools.[15] The parties must stipulate "to the fullest extent to which complete or qualified agreement can or fairly should be reached" all relevant, non-privileged facts and documents.[16] Informal discovery efforts often fizzle at some point, which is when the parties engage in formal discovery by issuing to their opponents interrogatories, requests for admissions, and requests for production of documents.[17] The parties enjoy significant latitude in making inquiries; they can seek any data that is non-privileged and that "is relevant to the subject matter involved in the pending case."[18] The fact that the specific data sought by

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1 Section 6011(a); Treas. Reg. § 1.6011-1(a).

2 Section 6001; Treas. Reg. § 1.6011-1(a).

3 Treas. Reg. § 1.6011-1(e).

4 Section 7602(a); Treas. Reg. § 301.7602-1(a); David M. Richardson et al., Civil Tax Procedure, LexisNexis, 2005, pgs. 95-104.

5 Section 7602(a); Treas. Reg. § 301.7602-1(a).

6 Section 7604(b); Section 7210.

7 David M. Richardson et al., Civil Tax Procedure, LexisNexis, 2005, pg. 96.

8 Tax Notes Doc. 2020-7524 (Feb. 25, 2020), consisting of LB&I-04-0220-004.

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

10 IRM Exhibit 4.46.4-2.

11 Tax Notes Doc. 2020-7524 (Feb. 25, 2020), consisting of LB&I-04-0220-004.

12 Frederic Lee, "IRS Emphasizes Summons Power in Conservation Easement Cases," 2020 Tax Notes Today Federal 222-3 (Nov. 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").

13 Frederic Lee, "IRS Emphasizes Summons Power in Conservation Easement Cases," 2020 Tax Notes Today Federal 222-3 (Nov. 17, 2020).

14 Tax Court Rule 34(b)(4) and (5).

15 *Branerton Corp. v. Commissioner*, 61 T.C. 691 (1974).

16 Tax Court Rule 91(a)(1); Internal Revenue Manual § 35.4.3.2 (08-11-2004).

17 Tax Court Rule 70(a)(1).

18 Tax Court Rule 70(b).

19 Id.

20 Tax Court Rule 70(c)(1).

21 Tax Court Rule 70(c)(3).

22 *Hickman v. Taylor*, 329 U.S. 495 (1947).

23 Identical rules are located in Rule 26(b)(3) of the Federal Rules of Civil Procedure and Rule 70(c)(3) of the Tax Court Rules of Practice and

the parties cannot be introduced as evidence during a Tax Court trial is not an impediment, as long as such data "appears reasonably calculated to lead to discovery of admissible evidence."[19]

The use of discovery tools is not limitless, of course. The Tax Court can control the frequency or extent of data requests when it determines that the data sought is unreasonably cumulative or duplicative, the party seeking the data could obtain it more conveniently from another source or already had an "ample opportunity," or the request is "unduly burdensome or expensive."[20] Importantly for purposes of this article, the Tax Court can also shield documents from discovery requests pursuant to the work-product doctrine.[21]

Select Authorities on the Work-Product Doctrine

This article is *not a* comprehensive treatise on the work-product doctrine; it focuses on the scope of the work-product doctrine in the context of tax disputes. The most relevant cases and rules are covered below.

Supreme Court Origin

The seminal case, decided by the Supreme Court way back in 1947, was *Hickman v. Taylor*.[22] A tugboat was towing a vessel across a river, an accident occurred, and several crew members drowned. Days later, the owners of the tugboat and their insurance company hired a law firm to defend them against potential lawsuits by representatives of the dead crew members. A regulatory agency held a public hearing at which four of the survivors spoke. Their testimony was recorded and made available to all. Soon thereafter, an attorney with the defense firm privately interviewed the survivors and "took [signed] statements from them with an eye toward the anticipated litigation." Representatives of two deceased crew members were already in communication with the attorney at the time he obtained the statements.

Most of the representatives settled their cases with the tugboat owners, but one proceeded to trial. Counsel for the plaintiff served interrogatories on the tugboat owners as part of the pre-trial discovery process. He sought, among other things, copies of the statements that the defense attorney had previously secured from the four survivors. The defense attorney refused on grounds that the statements constituted privileged matter obtained in preparation for trial. Counsel for the plaintiff, in light of this impasse, requested judicial assistance.

The District Court disagreed with the defense attorney, instructed him to release the statements, and held him in contempt when he disobeyed. The defense attorney then sought intervention from the Court of Appeals, which vindicated him by ruling that the statements were "part of the work product of [the defense attorney] and hence privileged from discovery." Finally, the Supreme Court weighed in.

The Supreme Court generally acknowledged that the discovery rules should be interpreted broadly and knowledge of the facts by all parties is essential to litigation, but warned that discovery has "ultimate and necessary boundaries." The Supreme Court characterized the plaintiff's demands as an attempt to obtain written statements and mental impressions of the defense attorney, without any showing of necessity, prejudice, hardship or injustice. Indeed, the Supreme Court pointed out that the essence of what the plaintiff was seeking had already been disclosed to him through interrogatories or was readily available to him by directly interviewing the four survivors. Concluding its thoughts on the plaintiff's situation, the Supreme Court explained that "[n]ot even the most liberal of discovery theories can justify unwarranted inquiries into the files and mental impressions of an attorney."

Court Rules

The concepts discussed in *Hickman v. Taylor*, above, are now found in both the Federal Rules of Civil Procedure and the Tax Court Rules of Practice and Procedure.[23] For the sake of simplicity, this article solely refers to the former. Rule 26 generally explains that parties may obtain discovery regarding any matter, provided that it is unprivileged, relevant to a claim or defense, and proportional to the needs of the case at hand.[24] There are exceptions, of course. Notably, Rule 26 establishes that a party normally *cannot* discover (i) documents or other tangible things, (ii) prepared in anticipation of litigation, (iii) or prepared for trial, (iv) by the other party, (v) or for the other party, or (vi) by or for a representative of the other party, including attorneys, consultants, sureties, indemnitors, insurers, or agents.[25]

The courts might allow discovery of such materials, though, where the party requesting them can show that it has a substantial need for the materials to pre-

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Procedure. For simplicity, this article refers only to the former.

24 Federal Rule of Civil Procedure 26(b)(1).

25 Federal Rule of Civil Procedure 26(b)(3)(A); Federal Rules of Civil Procedure 26(b)(3), Notes of Advisory Committee on Rules, 1970 Amendment.

26 Federal Rule of Civil Procedure 26(b)(3)(A)(i) and (ii).

27 Federal Rule of Civil Procedure 26(b)(3)(B).

28 Federal Rules of Civil Procedure 26(b)(3), Notes of Advisory Committee on Rules, 1970 Amendment.

29 Federal Rule of Civil Procedure 26(b)(5).

30 *Bernardo v. Commissioner*, 104 T.C. 677 (1995).

31 *Bennett v. Commissioner*, TC Memo 1997-505.

32 *United States v. Adlman*, 134 F.3d 1194 (2nd Cir. 1998).

33 *United States v. Roxworthy*, 457 F.3d 590 (6th Cir. 2006).

34 Action-on-Decision 2007-004 (Oct. 1, 2007).

35 Id.

36 Id.

37 Id.

38 Internal Revenue Manual § 5.17.6.14 (10-15-2010).

39 *Deseret Management Corp. v. United States*, 76 Fed. Cl. 88 (2007).

40 *Evergreen Trading, LLC v. United States*, 80 Fed. Cl. 122 (2007).

41 *United States v. Windsor Capital Corporation*, 100 AFTR 2d 2007-6827 (DC Ma. 2007).

42 *Regions Financial Corporation & Subsidiaries v. United States*, 101 AFTR 2d 2008-2179 (2008).

43 *United States v. Richey*, 632 F.3d 559 (9th Cir. 2011).

44 *United States v. Veolia Environ. North America Operations*, 112 AFTR 2d 2013-6675 (DC Del. 2013).

45 *United States v. Sanmina Corporation*, 115 AFTR 2d 2015-1882 (DC Ca. 2015).

46 *Schaeffler v. United States*, 806 F.3d 34 (2nd Cir. 2015).

pare its case and it cannot obtain the materials (or their substantial equivalent) by other means without incurring undue hardship.[26] Even if the courts permit discovery under these narrow circumstances, they must do so in a way that protects against revelation of mental impressions, conclusions, opinions and/or legal theories of a party's attorney or other representative.[27] According to commentators, these unique rules reflect the view that "each side's informal evaluation of its case should be protected, that each side should be encouraged to prepare independently, and that one side should not automatically have the benefit of the detailed preparatory work of the other side."[28]

In terms of procedure, the party that refuses to provide materials in response to a discovery demand on grounds that they are covered by the work-product doctrine must expressly make the claim and then describe the nature of the materials in a manner that will allow the other party to evaluate the claim, without disclosing information that supposedly is protected.[29]

Bernardo v. Commissioner[30]

The taxpayer claimed a charitable deduction of approximately $600,000 on his Form 1040 (U.S. Individual Income Tax Return) for 1986 in connection with the donation of a large granite sculpture, called Omphalos. The IRS audited, announced its primary position that the taxpayer was entitled to a tax deduction of $0, and proposed a list of alternative penalties in its Notice of Deficiency. The taxpayer filed a Petition with the Tax Court challenging the IRS's assertions.

Background on Discovery Dispute

The parties engaged in pre-trial discovery, which, as often occurs, resulted in disagreement. Therefore, the IRS filed a Motion with the Tax Court asking it to obligate the taxpayer to hand over certain documents related to the appraisal of Omphalos. The taxpayer objected to the Motion on several grounds, including that the work-product doctrine spared the materials. For its part, the taxpayer also filed a separate Motion, requesting assistance from the Tax Court in making the IRS relinquish certain documents and respond to certain interrogatories.

The taxpayer submitted an affidavit from its attorney during the discovery hearing before the Tax Court. The affidavit indicated that the taxpayer hired the attorney to provide legal advice regarding the possible donation of Omphalos, the attorney hired the appraiser on behalf of the taxpayer solely for purposes of determining the fair market value of Omphalos, and the attorney would have been unable to render legal advice without assistance from the professional art appraiser. The attorney acknowledged during the hearing that he did not actually pay the appraiser (presumably the taxpayer did so), but he nonetheless engaged the appraiser in the sense that he identified him as an expert, discussed the project with him, and oversaw the work.

An accountant also testified during the hearing. He explained that the taxpayer engaged him to assist with the preparation of his Forms 1040 and to represent him during any related IRS audits. The accountant further stated that, as part of the audit process, the Revenue Agent notified him in April 1991 that the specialized "IRS Art Advisory Panel" had determined that the value of Omphalos was substantially less than what the taxpayer had claimed on his Form 1040. Upon receipt of such notice, the accountant told the taxpayer and the attorney that they "would have to legally challenge the IRS's position" regarding valuation.

Rulings on the IRS's Motion

The Tax Court began, logically, by citing to the rules established by the Supreme Court in *Hickman v. Taylor* and their evolution thereafter. Among other things, the Tax Court noted that "[l]itigation is frequently anticipated prior to the time a lawsuit is actually commenced." It further observed that the "scope of the protection of provided by the work-product doctrine is broader than the protection afforded by the attorney-client privilege" because the former safeguards materials prepared in anticipation of litigation by a representative of a party, regardless of whether such representative was hired directly by the party or indirectly by the party's attorney.

The IRS adopted the position that the work-product doctrine only applies to documents prepared *after* the IRS issues a Notice of Deficiency to a taxpayer. The Tax Court rejected that argument, holding that a document can be prepared "in anticipation of litigation" before the IRS completes its audit and issues a Notice of Deficiency. The Tax Court underscored that once the Revenue Agent informed the taxpayer (through his accountant) that the IRS Art Advisory Panel had concluded that Omphalos was worth substantially less than the

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

48 IRS Notice 2017-10, 2017-4 Internal Revenue Bulletin 544 (Dec. 23, 2016).

49 Notice 2017-10, Section 1.

50 IRS Information Release 2020-130 (June 25, 2020).

51 *See, e.g.,* IR-2019-47 (March 19, 2019).

52 IR-2020-160 (July 16, 2020).

53 Nathan J. Richman, "Multiple Divisions Coming for Syndicated Conservation Easements," 2019 Tax Notes Today 220-3 (Nov. 13, 2019); William Hoffman, "Conservation Easement Crackdown a Portent, Rettig Says," 2019 Tax Notes Today 221-9 (Nov. 14, 2019); Kristen A. Parillo, "IRS Is Building Up Its Easement Toolbox," 2019 Tax Notes Today 222-6 (Nov. 15, 2019); Kristen A. Parillo, "IRS Looking for Promoter Links as Easement Crackdown Grows," Tax Notes Today, Doc. 2019-47134 (Dec. 13, 2019); Kristin A. Parillo, "Syndicated Easement Players Getting Referred to OPR," 2020 Tax Notes Today Federal 223-5 (Nov. 18, 2020).

54 Internal Revenue Service, Conservation Easement Audit Techniques Guide (Rev. 11/4/16), pgs. 78-81.

55 *United States v. Nancy Zak, Claud Clark, EcoVest Capital Inc., Alan N. Solon, Robert M. McCullough, and Ralph R. Teal*, Case No. 1:18-cv-05774, D.C. N.D. Ga, Complaint filed Dec. 18, 2018.

56 Kristen A. Parillo. "IRS Assigns Point Person on Promoter Investigations," Federal Tax Notes Today Doc. 2020-6890 (Feb. 25, 2020); IR-2020-41 (Feb. 24, 2020).

57 Kristen A. Parillo, "IRS Looking for Promoter Links as Easement Crackdown Grows," Tax Notes, Doc. Number 2019-47134 (Dec. 13, 2019).

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

59 IR-2021-88 (April 19, 2021).

amount he claimed on his Form 1040, "it was reasonable for [the taxpayer] and [his] representatives to anticipate litigation [with the IRS] concerning those deductions."

Rulings on the Taxpayer's Motion

The taxpayer wanted several items from the IRS, including a copy of a memo written by an Appeals Officer in response to comments by an IRS attorney about a draft Notice of Deficiency. As explained above, in support of *its* own Motion to obligate the taxpayer to disclose certain documents, the IRS contended that the work-product doctrine does not come into play until after the IRS issues its Notice of Deficiency. However, in trying to defend against a similar Motion filed by the taxpayer, the IRS, seemingly oblivious to its hypocrisy, took the opposite stance. It argued, in particular, that the work-product doctrine should prevent disclosure of a memo written by an Appeals Officer before issuance of the Notice of Deficiency.

The Tax Court held in favor of the IRS, but only in narrow circumstances. Specifically, the Tax Court explained the general rule that documents written by a Revenue Agent or Appeals Officer are *not* considered prepared in anticipation of litigation. However, if they write a document "at the direction of an [IRS] attorney," then it is protected by the work-product doctrine.

Bennett v. Commissioner[31]

The taxpayer donated 236 films to an art institute and claimed a charitable deduction of $236,000, or $1 per film. The IRS audited the taxpayer. The Revenue Agent utilized an in-house valuation engineer ("First Engineer") during the audit. He suggested that the films were worth $0. Next, the Revenue Agent hired an appraiser who was not an IRS employee ("Independent Appraiser"), who prepared the report that became the focus of this case ("Report"). Later, the Revenue Agent had another in-house valuation engineer ("Second Engineer") value the films. He opined that the films were worth half the value claimed by the taxpayer, or $118,000. The IRS eventually issued a Notice of Deficiency relying on the conclusions of the Second Engineer. The taxpayer disagreed and filed a Petition with the Tax Court.

The parties later found themselves in a discovery dispute, with the taxpayer filing a Motion with the Tax Court, asking it to force the IRS to turn over all items related to the valuations, including the Report by the Independent Appraiser. The IRS argued that the Report was exempt from disclosure because the IRS obtained it in anticipation of litigation, even though this occurred during the audit.

The Tax Court explained that the Revenue Agent obtained the Report during an audit and *before* the IRS issued a Notice of Deficiency. It also underscored that the IRS could not demonstrate that one of its attorneys was involved in the audit when the Independent Appraiser was hired, that he prepared the Report at the direction of any IRS attorney, or that the Report was "in any way prepared in anticipation of litigation." The Tax Court then pointed out that the IRS was taking a position that was entirely inconsistent with the one it previously advocated in *Bernardo v. Commissioner*. In that earlier case, the IRS argued that the work-product doctrine only applies to documents prepared after the IRS issues a Notice of Deficiency to a taxpayer. In this case, by contrast, the IRS urged the Tax Court to determine that the work-product doctrine applied to documents created during the audit and before the issuance of the Notice of Deficiency. The Tax Court held that the IRS failed to prove that it anticipated litigation at the time it obtained the Report, because it did not even show the Report to the taxpayer or use it in preparing the Notice of Deficiency. Moreover, the Tax Court held that the narrow exception favoring the IRS discussed in Bernardo v. Commissioner was inapplicable because IRS attorneys were not involved with the audit, Report, or anything else before the Notice of Deficiency.

United States v. Adlman[32]

Sequa Corporation ("Sequa") was a large aerospace manufacturer. It contemplated merging two of its subsidiaries, which would have resulted in an enormous loss and corresponding tax refund. Sequa expected the IRS to audit the transaction. Therefore, it hired a major advisory firm to prepare a tax analysis ("Memo"). It contained (i) an evaluation of likely tax and legal challenges by the IRS, (ii) a discussion of relevant law, regulations, legislative history, cases and administrative rulings, (iii) theories and strategies that Sequa could adopt, (iv) recommendations of ways to structure the transaction, and (v) predictions about likely results of tax litigation. Sequa proceeded with the transaction after reviewing the Memo. It generated a loss of about $290 million and a tax refund of $35 million; big numbers all around.

The IRS audited and sought many documents from Sequa, including the Memo. Sequa declined, so the IRS requested assistance from the District Court in enforcing its Summons. What followed was a considerable amount of judicial back and forth, with the District Court rejecting Sequa's position that the attorney-client privilege or the work-product doctrine protected the Memo, and the Court of Appeals repeatedly remanding the case on grounds that the District Court was flat wrong in many

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60 IRS News Release IR-2020-49 (March 5, 2020); IR-2020-102 (May 26, 2020).

61 IRS Chief Counsel Memorandum AM-2020-010 (Oct. 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 (Oct. 5, 2020); IRS Chief Counsel Memorandum AM-202044009 (Oct. 23, 2020) (called "Determining the Fraud Penalty in BBA Syndicated Conservation Easement Cases").

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

63 IR-2019-182 (Nov. 12, 2019).

64 IR-2020-125 (June 10, 2022) (emphasis added).

65 Nathan J. Richman. "IRS Shifting Tack on Fighting Syndicated Conservation Easements," Tax Notes Doc. 2022-3795 (Feb. 7, 2022) (emphasis added).

66 IR-2019-213 (Dec. 20, 2019) (emphasis added).

67 Section 6662; Section 6662A; Section 6663.

ways. Ultimately, the dispute worked its way back up to the Court of Appeals, which rewarded the parties with a detailed analysis about the proper standard for determining when a document is prepared "in anticipation of litigation" with the IRS.

The Court of Appeals underscored that the case presented the following issue of first impression for the Second Circuit: Whether the work-product doctrine found in Rule 26 applies to "a litigation analysis prepared by a party or its representative in order to inform a business decision, which turns on the party's assessment of the likely outcome of [tax] litigation expected to result from the transaction." The Court of Appeals described the genesis of the work-product doctrine in the Supreme Court case, *Hickman v. Taylor*, followed by its codification in Rule 26. With those preliminaries out of the way, the Court of Appeals explained that two major standards have evolved: The "primarily or exclusively to assist in litigation" standard, and the "because of" existing or expected litigation standard. The Court of Appeals declared that it would adhere to the latter, the "because of" standard, because it is more consistent with *both t*he express language of Rule 26 and the policies underlying Rule 26.

The Court of Appeals provided several justifications for its decision.

First, it pointed out that Rule 26 specifically covers materials "prepared in anticipation of litigation" or "prepared for trial." The fact that the drafters of Rule 26 used the phrase "prepared in anticipation of litigation," instead of merely "prepared for litigation," shows they considered the former a "different and broader category."

Second, the Court of Appeals pointed out that Rule 26 grants a "special level of protection" to documents containing legal analysis. In particular, in situations where a court forces disclosure of a document because the requesting party has a "substantial need" for it and cannot obtain the substantial equivalent without incurring undue hardship, the court "must protect" against revealing mental impressions, conclusions, opinions, and/or legal theories of an attorney or other representative. The Court of Appeals concluded that, given this "special level of protection," it would "oddly undermine" the function of Rule 26 if such documents were outside the work-product cocoon merely because they were prepared in making a business decision expected to end up in litigation.

Third, the Court of Appeals presented three scenarios involving a *legal* analysis, prepared by an attorney or another representative of a party, which was used for making a business decision. If one were to apply the "primarily or exclusively to assist in litigation" standard urged by the IRS, then none of the analyses would enjoy protection from the work-product doctrine. The Court of Appeals explained that this would cause taxpayers to make an "untenable choice." On one hand, they could forego the analysis, or get a vague and incomplete one, to avoid damaging its positions in future litigation. On the other hand, they could get a candid analysis and make an informed business decision, but later suffer in litigation after being obligated to relinquish the analysis to its adversary. The Court of Appeals observed that nothing in the explicit language of Rule 26 or its policies justifies subjecting taxpayers to this type of "undesirable choice." It then concluded as follows:

> We see no basis for adopting a test under which an attorney's assessment of the likely outcome of litigation is freely available to his litigation adversary merely because the document was created for a business purpose rather than for litigation assistance. The fact that a document's purpose is business-related appears irrelevant to the question of whether it should be protected by Rule 26.

Fourth, the Court of Appeals indicated that the Seventh Circuit Court of Appeals, various District Courts, and legal commentators have also rejected the "primarily or exclusively to assist in litigation" standard advanced by the IRS. Conversely, the Third, Fourth, Eighth and Courts of Appeals for other Circuits have formally adopted the "because of" litigation standard.

United States v. Roxworthy[33]

The IRS conducted a federal income tax audit of Yum! Brands, Inc. ("Yum") with respect to its Forms 1120 (U.S. Corporation Income Tax Return), presumably with an eye toward tax issues related to its use of a captive insurance company. The IRS issued various IDRs as part of the audit. Yum declined to provide certain documents on grounds that they were protected by the work-product doctrine. The IRS, in response, issued Yum a Summons demanding several documents listed in its privilege log. Yum ultimately relinquished all but two documents. These consisted of memos prepared by KPMG analyzing the tax consequences to Yum of transactions linked to the captive insurance company, challenges that the IRS might raise, and possible counterarguments.

The IRS filed a Motion in District Court, asking it to obligate Yum to turn over the two KPMG memos. The Magistrate Judge held in favor of the IRS, issuing a Report and Recommendation that the Summons be enforced. His reasoning was that the KPMG memos were not work product because they were not created in anticipation of litigation, but rather to assist Yum in preparing its annual taxes and internal audit.

Yum then filed a Motion to expand the court record to include additional evidence. The District Court approved the Motion, and Yum submitted affidavits stating that the KPMG memos were prepared in anticipation of litigation because (i) Yum was going to recognize a loss of $112 million for tax purposes but not for book purposes, (ii) this tax loss would be conspicuous on its Form 1120, (iii) Yum was certain that it would be audited due to its size, (iv) the proper tax treatment of premium payments to captive insurance companies was unsettled, and (v) Yum believed that the IRS would litigate the matter because of considerable prior litigation between the IRS and other taxpayers about captive insurance issues. The District Court was unfazed by this new evidence, adopting the earlier Report and Recommendation by the Magistrate Judge and issuing an Order enforcing the Summons. Yum then filed an Emergency Motion for a Stay of the case while it elevated matters to the Six Circuit Court of Appeals.

The Court of Appeals began with a brief history of the work-product doc-

trine, discussing the initial holding by the Supreme Court in *Hickman v. Taylor* and the current guidance in Rule 26. It then acknowledged that it had yet to define the key phrase "in anticipation of litigation." Based on the reasoning in several other cases, the Court of Appeals adopted the "because of" test as the standard for determining whether particular documents have been prepared "in anticipation of litigation." The Court of Appeals, citing Rule 26, explained that documents prepared in the ordinary course of business, pursuant to public requirements, or for any non-litigation purpose are not shielded by the work-product doctrine. Thus, clarified the Court of Appeals, a document that would have been prepared in substantially the same manner regardless of anticipated litigation is not covered. The Court of Appeals eventually concluded that the work-product doctrine would apply where (i) a document was created because of a party's *subjective* anticipation of litigation, and (ii) such subjective anticipation was objectively reasonable.

The Court of Appeals made some noteworthy rulings in addressing the leading element, subjectivity. First, it held that "Yum's unambiguous sworn affidavits and deposition testimony satisfy its burden of demonstrating that the [KPMG memos] were prepared due to Yum's subjective anticipation of litigation and not in the ordinary course of business." Second, it noted that the KPMG memos did not lose their work-product status solely because they were prepared, in part, to assist Yum in avoiding potential penalties if it were audited. On this score, the Court of Appeals emphasized that "a document can be created for both use in the ordinary course of business and in anticipation of litigation without losing its work-product privilege."

The Court of Appeals then turned its attention to the second element, objectivity. It explained that Yum identified the transaction that could precipitate litigation with the IRS, the specific legal/tax matters that would be at issue in such litigation, the IRS's opportunity to discover the controversial facts, and the IRS's general inclination to pursue this sort of litigation. The Court of Appeals concluded that Yum's circumstances "clearly constitute objectively reasonable anticipation of litigation under any of the tests we have seen by our sister circuits," and the Magistrate Judge and District Court previously erred in ruling that Yum's anticipation of litigation was "too remote" to be reasonable.

The Court of Appeals reversed the District Court's earlier Order to enforce the Summons and instructed it to rule in favor of Yum instead.

Action-on-Decision[34]

The IRS, upset about its loss in *United States v. Roxworthy,* quickly issued an Action-on-Decision announcing that it planned to ignore the Sixth Circuit Court of Appeals.[35] In other words, although the IRS demands that *taxpayers* heed judicial determinations, the IRS proclaimed that it could simply disregard them at its whim. The IRS offered the following justification for its disobedience:

> A document prepared in anticipation of an audit, even if it focuses on a particular transaction or items, is not prepared in anticipation of litigation. If a document is prepared before even an audit has been initiated, the specter of litigation is, absent objective facts not present in [*United States v. Roxworthy],* too insubstantial and attenuated to support a conclusion that the possibility of litigation is "concrete or significant." Therefore, the [KPMG memos] should not be protected by the work-product doctrine. As a result, the [Court of Appeals] erred in reversing the District Court.[36]

Doubling down on the tough talk, the IRS warned that it would "continue to aggressively seek the enforcement of summonses, challenging unjustified assertions of the work-product doctrine (and other privileges) in all appropriate cases, including those that would be appealable to the Sixth Circuit."[37] Its initial vehemence in the Action-on-Decision notwithstanding, the IRS has subsequently recognized the validity of *United States v. Roxworthy* in other places. Specifically, the IRS cites to that case and others in its Internal Revenue Manual, explaining that a court should look to the purpose or function for which a document was prepared, and not its content, when deciding whether it was created "because of" anticipated tax litigation.[38]

***Deseret Management Corporation v. United States*[39]**

This case involved Deseret Management Corporation ("DMC") alleging that the IRS had erroneously assessed and collected certain income taxes. The parties engaged in the pre-trial discovery process until they hit a snag. Namely, the IRS refused to turn over certain documents to DMC on grounds that they were protected by, among other things, the work-product doctrine. Yes, that is correct, it was the IRS, not DMC, trying to screen documents based on claims of work-product protection. The details in this case were scant, but it appears that the disputed documents involved communications between IRS attorneys and non-legal personnel in its Appeals Office.

DMC filed a Motion to compel the IRS to release the documents. Despite the fact that the IRS announced in its Action-on-Decision that it would never follow *United States v. Roxworthy,* the IRS relied on that exact case as its primary defense.

The court explained that DMC was a corporation that served as a holding company for various subsidiaries. The sale of one subsidiary, which was at the heart of the tax dispute, represented a major business transaction involving tens of millions of dollars. Due to the size of DMC and the significance of the transaction, the court indicated that both DMC and the IRS "knew or should have known that the auditing process could lead to litigation." The court found support for this conclusion in the IRS's acknowledgement that the valuation of the subsidiary was a hotly contested issue, and, if the parties could not reach an agreement, the IRS would issue a Notice of Deficiency. The court held that the written communications between IRS attorneys and the Appeals Office were prepared "in anticipation of litigation," and contained mental impressions, conclusions, opinions, and legal theories of the IRS attorneys. Therefore, they were exempt from discovery under Rule 26.

Evergreen Trading, LLC v. United States[40]

In a federal income tax dispute, the Department of Justice filed a Motion aimed at making the taxpayer relinquish certain documents. The taxpayer refused to do so, citing several defenses, including the work-product doctrine.

The court observed that Rule 26 was vague in terms of timing, but various cases have set certain parameters:

> [I]t is well-recognized that for the [work-product doctrine] to apply, litigation need not already have commenced or be imminent; rather, litigation must merely be a real possibility at the time the documents in question are prepared. For this purpose, litigation has been understood to include proceedings before administrative tribunals if they are adversarial in nature.

The court then observed that less agreement exists with respect to the meaning of "anticipation of litigation." It explained that two main formulations have evolved. Some courts apply the "primary purpose test," which dictates that a document will be considered prepared in anticipation of litigation, and thus protected by the work-product doctrine, if the "primary motivating purpose behind the creation of a document was to aid in possible future litigation." Other courts prefer a "simple causation test," which requires that a document be prepared or obtained because of the prospect of future litigation. After supplying several rationales, the court concluded that the "simple causation test," otherwise known as the "because of" test, was the more logical and widely accepted standard. The court cited several cases in arriving at its conclusion, including *United States v. Roxworthy.*

United States v. Windsor Capital Corporation[41]

Certain family trusts donated property worth $18.5 million to a foundation, which, in turn, sold such property for $18.5 million and donated the cash to a charitable organization. The charitable organization then took the $18.5 million, along with $45.5 million from unrelated sources, and bought a farm owned by the family for $64 million. The transaction allegedly allowed the family members to donate $18.5 million in property, claim a corresponding charitable tax deduction, and then get the money back through the sale of different property at an inflated price. The IRS argued that this was improper because the $18.5 million was "funneled back to the [family] in the form of the increased purchase price" for the farm. The IRS further contended that taxpayers cannot claim a charitable deduction if they expect a "substantial benefit" in return for their donation. The family hired two reputable tax law firms to negotiate and structure all aspects of the transaction. The firms "conceived of the circular structure of the transaction no doubt in an effort to maximize tax benefits."

As part of the audit process, the IRS sent a Summons seeking various documents related to the transaction, including those created by the law firms and in-house counsel for the family. It appears that compliance was lacking, so the IRS asked the District Court to enforce the Summons. The IRS urged the District Court to allow it access to the pertinent documents under several theories, including that the work-product doctrine was inapplicable. The District Court denied the IRS's request, as follows:

> The work-product privilege applies here. The planning and structuring was performed in anticipation of litigation. At least one of the privileged documents specifically references anticipated litigation in that it seeks advice regarding the likely outcome in a Tax Court proceeding of various possible positions. In light of the size of the donation and deductions [*i.e.,* $18.5 million] as well as the nature of the transactions, an audit and subsequent Tax Court proceedings were reasonably anticipated.

Regions Financial Corporation v. United States[42]

The IRS audited the Forms 1120 of the taxpayer ("Company") for 2002 and 2003. During those years, the Company engaged in certain "listed transactions." The IRS, as part of its audit, sent a Summons to the Company's financial auditor, Ernst & Young ("EY"), demanding a large number of documents. EY provided thousands of documents, but withheld or heavily redacted some on grounds that they were protected by the work-product doctrine. The documents at issue consisted of three created by a law firm evaluating legal theories, expressing opinions, and analyzing possible attacks by the IRS of the Company's tax treatment of the transactions. They also encompassed a document that evaluated the transactions, which was prepared by tax partners at EY who were uninvolved in the financial auditing of the Company. These key documents were prepared at the request of the General Counsel for the Company, who normally got involved in tax matters only if litigation was likely to occur.

Because EY refused to comply with the Summons based on instructions from the Company, the IRS sought assistance from the District Court in enforcing it. The District Court observed that the courts have struggled over time in articulating a clear definition for "in anticipation of litigation" in the context of a Summons issued by the IRS. It then summarized the standards established by the Fifth Circuit Court of Appeals (*i.e.,* the "primary purpose" test) and by the Second Circuit Court of Appeals (*i.e.,* the "because of" test). The District Court declined to say which test applied in the Eleventh Circuit because it concluded that the Company would prevail under *either test.*

The IRS argued that the Company obtained the relevant documents to create a tax reserve that matched its contingent liabilities, which was a prerequisite to getting an unqualified audit opinion from EY. Thus, reasoned the IRS, such documents would have been prepared to comply with the Company's public reporting requirements, regardless of any potential tax dispute with the IRS. The Company countered that it would not have a tax reserve in the first place if it did not believe that it was going to be attacked by the IRS over the transactions.

The District Court held in favor of the Company. It observed that "[w]ere it not for anticipated litigation, [the Company] would not have to worry about contingent liabilities and would have no need to elicit opinions regarding the likely results of litigation." The District Court acknowledged that litigation with

the IRS was not certain or imminent at the time the Company solicited the outside opinions, but it was not required. Citing *United States v. Roxworthy,* the District Court explained the following:

> It is clear in this case that [the Company] was primarily motivated by litigation when it solicited opinions about the potential outcomes of litigation from [the law firm and EY]. The fact that [the Company] undertook the time and expense of consulting outside firms to assess its potential liabilities shows that it believed litigation to be likely, and this court cannot say that [the Company's] subjective belief was objectively unreasonable.

The District Court went on to discard the IRS's argument that the work-product doctrine is lost if a document has more than one function. Without citing any authority for the proposition, the IRS argued that the Company cannot hide behind the work-product doctrine if the relevant documents "had any use other than litigation preparation." The District Court emphasized that it found no precedent supporting the notion that a party must demonstrate that "it was motivated by preparation for litigation and nothing else" in order for the doctrine to apply.

United States v. Richey[43]

The taxpayers owned interests in a partnership, which, in turn, held certain real property. In 2002, the taxpayers hired a law firm to provide legal advice concerning the possible donation of a conservation easement by the partnership. Next, the law firm, not the taxpayers, hired an appraiser to provide "valuation services and advice" regarding the easement donation. The appraiser prepared an appraisal, which the taxpayers enclosed as an exhibit to the relevant tax return, as required by the regulations. The appraiser also maintained his working file.

The IRS audited the taxpayers. As part of the process, the IRS issued a Summons to the appraiser, demanding that he appear before the Revenue Agent to disclose information and documents related to the appraisal. The appraiser, pursuant to the instructions of the law firm, refused to comply on grounds that such communications benefited from the work-product doctrine, among other protections. The IRS asked the District Court to enforce the Summons. Just two months later, the IRS issued the taxpayers a Notice of Deficiency. It claimed, unsurprisingly, that the conservation easement deduction should be worth $0 instead of $1.5 million.

The taxpayers paid the entire amount proposed by the IRS and then filed a Motion with the District Court to intervene (*i.e.,* participate) in the Summons enforcement action centered on the appraiser and his files. The position of the taxpayers can be summarized as follows: The IRS issued the Summons in good faith originally; The taxpayers paid the entire amount due according to the Notice of Deficiency; Full payment resulted in closure of the case; and Any efforts by the IRS to enforce the Summons thereafter were done in bad faith. The District Court ruled in favor of the taxpayers, and the IRS elevated the dispute to the Ninth Circuit Court of Appeals.

The Court of Appeals had a different opinion. It held in favor of the IRS because, thanks to some tricky procedural rules beyond the scope of this article, the liabilities of the taxpayers had not yet been "finally determined." Therefore, the IRS could proceed with the Summons it issued to the appraiser. That triggered an analysis by the Court of Appeals of the defenses presented by the appraiser, including the work-product doctrine. The Court of Appeals started by acknowledging that the work-product doctrine generally prevents disclosure to the IRS of documents, prepared in anticipation of litigation, by a taxpayer, or for a taxpayer, or by or for a representative of a taxpayer, including attorneys and agents. The Court of Appeals also recognized that dual-purpose documents, prepared in anticipation of tax litigation and for another reason, might be protected by the work-product doctrine. The Court of Appeals clarified that the "because of" test was the appropriate standard for determining whether a particular document falls under the work-product doctrine. It also emphasized the need to consider "the totality of the circumstances" in each case. The Court of Appeals then reasoned that (i) the law firm hired the appraiser to provide valuation services, (ii) the taxpayers enclosed the appraisal with their tax return, as required by law, (iii) had the taxpayers not done so, they would not have been entitled to a charitable tax deduction, and (iv) the taxpayers presented no evidence indicating that the appraiser would have prepared his work file any differently, regardless of whether tax litigation was anticipated. After reviewing "the totality of the circumstances," the Court of Appeals decided that the appraisal work file was not prepared "because of" anticipated litigation with the IRS.

The Ninth Circuit issued its decision in *United States v. Richey* many years before the IRS began engaging in at least 10 actions, discussed below, demonstrating that the IRS planned to examine all "syndicated" conservation easement donations, take the position that all related tax deductions should be $0, and litigate all cases before the Tax Court. Moreover, the case did not involve a "syndicated" situation in the first place. Thus, the "totality of the circumstances" in *United States v. Richey* are easily distinguishable from those in current cases and do not implicate the extreme IRS enforcement efforts addressed later in this article.

United States v. Veolia[44]

The taxpayer was a U.S. holding company of a large French conglomerate ("Veolia"). In 1999, Veolia purchased the stock of Water Application & Solutions Corporation ("WASCO") for $8.2 billion. It believed that such stock was worthless several years later, in 2006. Veolia considered whether converting WASCO into a limited liability company at that time would constitute a trigger for claiming a worthless stock deduction. As part of this process, Veolia hired a major law firm to analyze tax issues, obtained a Private Letter Ruling from the IRS, and hired two valuation companies to prepare reports about the insolvency of WASCO. Veolia then implemented the conversion.

Veolia was already under audit by the IRS in early 2007 with respect to its Forms 1120 for earlier years. In February 2007, before filing its Form 1120 for

2006 showing the large deduction, Veolia enrolled in the IRS's Pre-Filing Agreement program. It was created to "resolve, before returns are filed, issue that are likely to be disputed in post-filing audits." The IRS issued a Summons as part of its audit, and Veolia withheld certain documents on grounds that they enjoyed protection under various theories, including the work-product doctrine. The IRS, predictably, filed a Motion with the District Court, asking it to enforce the Summons.

Veolia contended that it anticipated litigation with the IRS over the worthless stock deduction in early 2006, when it hired the law firm, solicited the Private Letter Ruling, and retained the two valuation companies. The IRS countered that Veolia was in the business of acquiring, managing, restructuring, and selling companies, like WASCO, such that its activities were done in the ordinary course of business.

The District Court sided with Veolia. It held that the actions that Veolia took (including hiring the law firm, getting the Private Letter Ruling, hiring the valuation companies, and enrolling in the Pre-Filing Agreement program) combined to show that Veolia subjectively anticipated litigation. The District Court further held that Veolia's expectation of tax litigation was objectively reasonable because of the "sheer size of the deduction" at $4.5 billion and because the IRS was already auditing Veolia for prior years. Moreover, the withheld documents supported that conclusion. For instance, the memo prepared by the law firm indicated that Veolia expected the IRS to audit the entity conversion and related tax deduction. The District Court further observed that communications among Veolia, the law firm, and the appraisal companies indicate that "the valuation reports were a foundational part of a strategy to resist an IRS audit." The District Court added that the records as a whole corroborated Veolia's assertion that "it decided in early 2006 that a conversion of WASCO to [a limited liability company] was feasible and took steps over the ensuing months to bolster its legal position in an anticipated dispute with the IRS."

The District Court went on to explain that "there is no evidence that the specific transaction at issue . . . was undertaken for any purpose other than to enable [Veolia] to recognize a $4.5 billion loss on its tax return and then litigate with the IRS over the legitimacy of the deduction." The District Court added that its decision would be same, even if the IRS were correct in that business acquisition, restructuring, and loss-triggering were normal activities for Veolia. That is because "such an overlap" of purposes for obtaining documents did not necessarily deprive Veolia of the chance to claim protection of the work-product doctrine.

United States v. Sanmina Corporation[45]

Sanmina Corporation ("Sanmina") claimed a worthless stock deduction of approximately $500 million on its Forms 1120 for 2009. The IRS later audited and sent various IDRs. In an effort to substantiate the deduction, Sanmina supplied the IRS a valuation report by a major law firm. The report disregarded one large account-receivable on grounds that it constituted a simple bookkeeping entry with no financial impact. The report further explained that the law firm relied on two memos prepared by Sanmina's internal tax attorneys. The memos contained facts, analyses of relevant cases and IRS rulings, and legal conclusions. The IRS issued a Summons demanding the two memos, Sanmina declined, and the matter was elevated to the District Court.

One defense raised by Sanmina was the work-product doctrine. The IRS questioned application of such doctrine, suggesting that the memos were not created "in anticipation of litigation" because no IRS audit or litigation was pending at the time. The IRS also argued that the memos were produced for other purposes, such as return preparation.

The District Court clarified that it would employ the "because of" test and consider the totality of the circumstances surrounding the creation of the memos. The District Court explained that the memos constituted analyses of "complex business and legal issues that ultimately supported Sanmina's decision to take a worthless stock deduction." The District Court observed that a document does not lose work-production protection merely because it was created to assist with a business decision. Thus, "a legal tax analysis generated in anticipation of a possible IRS audit may constitute work product even if that material also assisted in making a business decision." The District Court also stated that "[t]he size of the worthless stock deduction [of approximately $500 million] meant that Sanmina could reasonably have anticipated that the IRS would scrutinize and challenge Sanmina's tax treatment."

Schaeffler v. United States[46]

The taxpayer was the majority owner of the Schaeffler Group, a German company that supplied automotive and industrial parts ("Group"). The Group wanted to acquire an interest in another company. The Group entered into a multi-billion dollar loan agreement with a consortium of banks to finance the offer. Circumstances changed significantly while the offer remained open, which threatened the Group's solvency and its ability to repay the consortium. Consequently, the Group and the consortium agreed that there was an urgent need to refinance the loan and restructure the Group. These actions would substantially affect the taxpayer's personal tax situation, as the majority owner of the Group. In light of the "complex and novel refinancing and restructuring," the taxpayer anticipated that the IRS would scrutinize him. As a result, he hired EY and a major law firm to advise on federal tax implications and possible future litigation with the IRS.

The IRS, as expected, audited the taxpayer. This led to the IRS issuing a Summons seeking all documents created by EY, and the taxpayer eventually filed a Motion with the District Court seeking permission to limit its response to the Summons. Among other items, the taxpayer wanted to withhold a memo prepared by its accountants ("EY Memo"). That document "identified potential U.S. tax consequences of the refinancing and restructuring, identified and analyzed possible IRS challenges to the [Group's] tax treatment of the transactions, and discussed in detail the relevant statutory provisions, U.S. treasury regulations, judicial decisions, and IRS rulings."

The District Court held in favor of the IRS, ruling that the EY Memo was not protected by the work-product doctrine for several reasons. First, the EY Memo did not specifically refer to litigation with the IRS. Second, the District Court explained that the taxpayer was a rational and sophisticated businessperson, who would want to obtain advice on the relevant tax laws, and who would routinely make efforts to comply with such laws. The taxpayer, therefore, would have obtained the EY Memo in the normal course, even if he had not anticipated an audit by or litigation with the IRS. Third, referencing the prohibition in Circular 230 against tax practitioners taking into account the possibility of an IRS audit in rendering tax advice to clients, the District Court concluded that the EY Memo would be the same, regardless of any anticipated tax dispute. The taxpayer appealed this initial decision by the District Court.

It is hard to imagine how the Court of Appeals could have disagreed more with the District Court. It began by pointing out that the District Court had acknowledged that the EY Memo was prepared at a time when the taxpayer believed that litigation with the IRS was highly probable and it described the strengths, weaknesses, and likely outcomes of potential legal arguments that the taxpayer might raise. The Court of Appeals next explained that the governing case, *United States v. Adlman*, described two extremes. On one hand, it held that documents created in the ordinary course of business, which would have been prepared irrespective of anticipated tax disputes, were not shielded by the work-product doctrine. On the other hand, if the nature of the documents and the surrounding circumstances indicate that documents were obtained "because of" the prospect of litigation, then they are protected. The Court of Appeals criticized the District Court for interpreting the ordinary-course-of-business standard so broadly that the work-product doctrine would *never apply*. The Court of Appeals emphasized that the EY Memo addressed the urgent circumstances triggered by the need for last-minute refinancing and restructuring, and were "necessarily geared to an anticipated audit and subsequent litigation, which was on this record highly likely." The Court of Appeals went on to attack the District Court's interpretation of the effect of Circular 230. It explained that the prohibition highlighted by the District Could concerned only situations in which advisers might recommend aggressive tax positions to clients solely because of a low probability of audit. According to the Court of Appeals, "[t]hat policy concern is simply not implicated here." The Court of Appeals then challenged the assertion of the District Court that the taxpayer would have secured the EY Memo regardless of potential issues with the IRS because he was a rational, sophisticated businessperson desirous of complying with all laws. The Court of Appeals opined that such a scenario "ignores reality" because the size of a transaction and the complexity of the tax treatment constitute important factors in dictating the likelihood of tax litigation. Finally, the Court of Appeals explained that the work-product doctrine can apply to documents obtained for dual purposes, tax and business. It stated the that earlier holding by the District Court "appears to imply that tax analyses and opinions created to assist in large, complex transactions with uncertain tax consequences can never have work-product protection," but that is contrary to the governing precedent established in *United States v. Adlman*.

Unique Aspects of Conservation Easement Disputes

Taxpayers who own undeveloped real property have several choices, one of which is to protect it forever by donating a "conservation easement." This option can generate both societal benefits and tax deductions for donors.[47] So-called "syndicated" conservation easement donations, usually made by partnerships, have garnered considerable attention over the past few years. Such scrutiny has led to some certainty, but not in a positive way.

Certainty of Examinations

The IRS has taken widespread enforcement actions against conservation easement donations over the past several years. One indisputable result of the IRS's efforts is that *all* partnerships that donate an easement likely expect, from the outset, that the IRS will examine them, take extreme tax and legal positions, propose the highest possible penalties, and eventually force them into tax litigation. See below some of the building blocks supporting this reality.

First, the IRS issued Notice 2017-10, labeling syndicated conservation easement donations "listed transactions."[48] The IRS warned at that time that it planned to attack donations based on the partnership anti-abuse rules, economic substance doctrine, and other unspecified theories.[49]

Second, the IRS launched a "compliance campaign" centered on conservation easements, devoting dozens of specialized Revenue Agents and other IRS personnel to the cause.[50]

Third, the IRS consistently featured conservation easements among the "dirty dozen."[51] They were absent from the list one year, but the IRS compensated by publishing a series of separate press releases identifying "illegal schemes and techniques," including "fraudulent conservation easements."[52]

Fourth, the IRS engaged in a media blitz, disseminating warnings in new releases, tax conference presentations, articles, and elsewhere. The IRS emphasized that it was (i) pursuing promoters, appraisers, return preparers, material advisors, accommodating entities, charitable organizations, and others, (ii) making referrals to the Office of Professional Responsibility, (iii) raising a long list of technical, procedural, legal, and tax arguments in easement disputes, while trying to develop more, (iv) asserting all possible civil penalties, (v) conducting simultaneous civil examinations and criminal investigations, and (vi) litigating a large number of cases.[53]

Fifth, the IRS began challenging every supposed "technical" flaw in connection with partnerships that donated conservation easements. These consisted of alleged shortcomings with appraisals, Deeds of Conservation Easement, Forms 8283 (Non-Cash Charitable Contributions), and other documents affiliated with donations. The Audit Technique

Guide published by the IRS contains an extensive list of technical items that it encouraged IRS personnel to pursue.[54]

Sixth, the government 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 conservation easements.[55]

Seventh, the IRS appointed a "Promoter Investigations Coordinator," who is in charge of interacting with the Civil Division, Criminal Investigation Division, Chief Counsel, and others to develop enforcement strategies.[56] The IRS then initiated various promoter investigations.[57] Building on that momentum, the IRS later announced formation of the "Office of Promoter Investigations," which was designed to expand on the ongoing efforts of the Promoter Investigations Coordinator.[58] The IRS underscored in that same announcement that halting improper easement donations ranked first on its list of priorities.[59]

Eighth, the IRS broadcasted that it had established a new "Fraud Enforcement Office" and hired a "National Fraud Counsel."[60] The IRS was not coy about the nexus between its burgeoning fraud team and conservation easements. Indeed, it issued two Chief Counsel Advisories within just a few months describing the methods by which the IRS can apply civil fraud penalties against partnerships donating easements.[61]

Ninth, the IRS announced that the Criminal Investigation Division would be running its own separate investigations related to conservation easement donations.[62]

Finally, in case the preceding nine items failed to demonstrate the high probability, if not absolute certainty, of an IRS challenge, the IRS's own declarations remove all doubt. It has proclaimed that it plans to attack every single syndicated conservation easement transaction, starting with examinations and ending with litigation. The IRS announced, for example, that it is conducting "coordinated examinations" across multiple divisions, it "will not stop in [its] pursuit of everyone involved," it will employ "every available enforcement option," and it is "committing significant examination and investigative resources to vigorously audit the entities and individuals involved in this scheme."[63] If that were not clear enough, the IRS also confirmed that it "*examines* 100 percent of these deals and plans to continue doing so for the foreseeable future."[64] Jumping on the kill-them-all-and-let-God-sort-them-out bandwagon, the National Fraud Counsel admonished that "the IRS is *auditing* 100 percent of these cases."[65] Chief Counsel for the IRS, piling on, explained that his troops are prepared "to take *each* of these [pending easement cases] and all other cases being developed by the IRS to trial."[66]

Certainty of IRS Positions

Not only are audits an inevitability, the positions that the IRS will take in litigation seem guaranteed, too. The IRS has implemented a widespread practice of issuing FPAAs or their equivalent, claiming that *all* partnerships that engage in syndicated conservation easements should get a charitable deduction of $0 and should be severely penalized, regardless of the amount of pre-donation due diligence performed, strength of the conservation values, existence of multiple appraisals, acquisition of relevant permits, etc. Notably, in issuing FPAAs triggering many years of expensive litigation, the IRS declines to specify any of the factual, legal, or tax reasons for its attacks. It invariably 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 deduction without supplying justifications, the IRS proposes several alternative penalties, ranging in severity. The IRS invariably leads with the sanction for a "gross valuation misstatement" and sometimes alleges that civil fraud occurred.[67]

Conclusion

Tax disputes are parables, yielding important lessons to those who are willing to take the time to reflect. This is certainly true for disputes centered on conservation easement donations. This article has identified the following realities, which tend to indicate that the IRS's radical actions might backfire when it comes to compelled disclosure of pre-donation documents.

During examinations and the Tax Court pre-trial discovery process, the IRS is aggressively seeking documents prepared in connection with the potential donation of conservation easements.

Taxpayers have various defenses to forced disclosure of documents by the IRS, including the work-product doctrine. The Supreme Court introduced the work-product doctrine many decades ago, in 1947. The work-product doctrine is now found in Rule 26 of the Federal Rules of Civil Procedure and in Rule 70 of the Tax Court Rules of Practice and Procedure. The work-product doctrine establishes that the IRS normally *cannot* discover (i) documents or other tangible things, (ii) prepared in anticipation of litigation, (iii) or prepared for trial, (iv) by a taxpayer, (v) or for a taxpayer, (vi) or by or for representatives of a taxpayer, including, but not limited to, attorneys, consultants, and agents.

Both taxpayers and the IRS, depending on the circumstances, have successfully argued that the work-product doctrine applies to materials prepared *before* the IRS issues its Notice of Deficiency, FPAA, or other final notice.

Most Courts of Appeal agree that the work-product doctrine protects a document if it was prepared "because of" existing or expected litigation with the IRS. The "because of" standard is met where a document was created because of a taxpayer's *subjective* anticipation of litigation, and such anticipation was objectively reasonable.

Seeking an analysis from a law firm or accounting firm, requesting a Private Letter Ruling from the IRS, and hiring valuation companies to evaluate and fortify tax positions might constitute evidence of a taxpayer's *subjective* anticipation of litigation. The size of a taxpayer, regularity with which a taxpayer is audited, significance of a transaction, complexity of tax issues, and the IRS's propensity to challenge certain matters are all factors that make a taxpayer's an*ticipation* of litigation objectively reasonable.

Tax litigation does not need to be certain, imminent, or underway for the work-product doctrine to apply; litigation must merely be a real possibility when the relevant documents are prepared. Dual-purpose documents, created for making business decisions *and* in anticipation of litigation, remain protected by the work-product doctrine.

The IRS has continually warned that it intends to examine "100 percent of these deals" and it is preparing "to take each [pending easement case] and all other cases being developed by the IRS to trial." Moreover, the IRS has instituted a practice of issuing FPAAs or their equivalents claiming that *all* partnerships that supposedly engaged in syndicated conservation easements should get a charitable deduction of $0 and penalized.

Partnerships whose activities might include the donation of a conservation easement, often in collaboration with planning counsel, hire various professionals to complete assorted due-diligence, valuation, environmental and other development-related projects. Partnerships might also task planning counsel with forming necessary entities, preparing legal, tax and/or regulatory analyses, reviewing assorted draft documents (*e.g.,* appraisals, Deeds of Conservation Easement, reports, etc.), and creating agreements necessary to implement relevant transactions.

Based on the preceding, one might argue that when partnerships hire planning counsel, representatives and agents early in the process they already anticipate litigation with the IRS because of the (i) potential for claiming large charitable tax deductions, (ii) complexity of the tax, legal and procedural issues surrounding conservation easements and the valuation thereof, and (iii) repeated declarations and actions by the IRS demonstrating that it plans to examine *all* syndicated conservation easement donations, take the position that all related tax deductions should be $0, and litigate all cases before the Tax Court. Taxpayers should be mindful of these points as conservation easement battles continue and the IRS aggressively seeks pre-donation materials. ●