Updates in IRS' Ongoing Enforcement Against Syndicated Conservation Easements

The IRS has been closely scrutinizing syndicated conservation easements since December 2017. In 2020, there have been some important developments in this area. First, in June 2020 the IRS announced a time-limited settlement opportunity for certain docketed Tax Court cases. Second, in August and September 2020, the Senate Finance Committee issued a report and data quantifying the amounts that syndicated conservation easements have allegedly cost the U.S. government. Third, some affected taxpayers have filed a class-action lawsuit against promoters of syndicated conservation easements.

Overview of Syndicated Conservation Easements

In general, a taxpayer who restricts development on qualified real property by granting a conservation easement to a qualified organization is entitled to a charitable deduction. Typical conservation easements garner bipartisan support. However, the IRS has scrutinized syndicated conservation easements, which many see as an opportunity for abuse. In a syndicated conservation-easement transaction, a promoter purchases a piece of real property and contributes such real property to a pass-through entity. The promoter then sells interests in the pass-through entity to investors. The pass-through entity donates the land to a government entity or qualified land trust and charitable deductions are passed along to the investors. In abusive situations, promotors seek grossly inflated valuations, which generate overstated deductions.

IRS Enforcement

In December 2017, the IRS issued Notice 2017-10, designating certain syndicated conservation easements as "listed transactions," which are subject to significant scrutiny. The IRS has since announced syndicated conservation easement transactions as an area of focus for enforcement, by launching a Large Business & International Division ("LB&I") compliance campaign in September 2018 and by including these transactions on the IRS's annual "Dirty Dozen" list of tax scams in 2019 and 2020. In November 2019, with IR-2019-182, the IRS announced a "significant increase in enforcement actions," explaining that coordinated examinations were being conducted by three IRS divisions: LB&I, Small Business & Self-Employed ("SBSE"), and Tax Exempt and Government Entities ("TGE"). The IRS also noted that it was working closely with the Department of Justice to pursue wrongdoers. The IRS explained they would be casting a broad net, pursuing those who promoted, assisted (*e.g.*, appraisers and return preparers), or participated in the transactions. Increased enforcement has resulted in many IRS victories in conservation easement cases. On October 1, 2020, IRS news release IR-2020-228 emphasized the IRS's continued efforts to combat abusive syndicated conservation-easement transactions. The IRS also announced that it would soon be updating its Conservation Easement Audit Technique Guide with new arguments that IRS would be making against taxpayers.

In ongoing litigation, the IRS has been broadly requesting documents of all persons involved, including attorneys and accountants. This is particularly noteworthy because the IRS recently released CC-2020-008, in which it described a number of scenarios under which IRS agents and attorneys may utilize third-party tax information discovered as part of syndicated conservation easement investigations in certain other proceedings, including to discern a pattern of fraudulent conduct that can indicate an intent to mislead.

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While the use of third-party tax information is limited under the Internal Revenue Code, CC-2006-003 highlights the item and transaction tests, which allow the use of information described in CC-2020-008. Under the item test, third-party tax information may be disclosed in judicial and administrative proceedings if the treatment of an item reflected on such third party's return is directly related to the resolution of an issue in the proceeding. This rule is broad enough to allow the disclosure of tax information of a taxpayer who participated in a substantially similar tax shelter promoted by the promoter under investigation. Under the transaction test, disclosure of third-party tax information may be permissible when such information directly relates to a transactional relationship between the third party and the party under investigation.

IRS Time-Limited Settlement Offers

In June 2020, in IR-2020-130, the IRS's Office of Chief Counsel proposed a time-limited settlement offer to resolve certain pending cases concerning syndicated conservation easements. The Office of Chief Counsel would reach out to eligible taxpayers regarding the potential settlement. On August 31, 2020, in IR-2020-196, the IRS announced its first settlement under this program with Coal Property Holdings LLC. This settlement was consistent with the terms of the IRS' settlement program:

- All partners agreed to settle, and the full amount of tax, penalties, and interest was paid before the settlement.
- No deduction was allowed for the value of the donated easement.
- Investors were permitted to deduct the purchase price of their partnership interests and pay a 10% penalty. (The settlement program's penalty range is 10–20%, and depends on the ration of the deduction claimed to the partnership interest.)
- The promoter was denied any deduction and was required to pay a 40% penalty, the maximum penalty asserted by the IRS.

The settlement came in the wake of an October 2019 Tax Court Opinion (153 T.C. 126) against Coal Property Holdings LLC, granting the U.S. government's motion for summary judgment and holding that certain provisions of the easement did not satisfy the regulations' perpetuity requirement.

IRS Chief Counsel Notice CC-2021-001, released on October 1, 2020, provided information to address questions related to the settlement opportunity and indicated that IRS Chief Counsel may consider extending settlement offers in newly filed cases.

Senate Finance Committee Report

On August 25, 2020, the Senate Finance Committee released a report on syndicated conservation easements ("the Report"). On September 21, 2020, the committee then released updated IRS data on syndicated conservation easements, which includes data received by the IRS in 2019 (mostly concerning transactions conducted in 2018). As part of the Senate Finance Committee's investigation, which started on March 27, 2019, the Senate requested information from 14 individuals suspected of promoting the transactions. According to the Report, promoters often promised investors two dollars in savings on their taxes for every dollar invested in the pass-through entity.

The Report estimates that between 2010 and 2017, syndicated conservation-easement transactions have collectively lowered investors' tax bills by approximately $10.6 billion. The Report and the updated data shows the IRS has identified 958 partnerships, which allegedly engaged in these types of transactions during tax years

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2015 through 2018, with 2018 being the year with the highest number of partnerships engaging in these transactions. As of February 2020, the IRS is either auditing or planning to audit approximately 84% of these partnerships.

The Report concluded that the IRS has strong reason for taking enforcement action against syndicated conservation-easement transactions and that Congress, the IRS, and the Department of Treasury should take further action to preserve the integrity of the conservation-easement charitable deduction.

Class Action Lawsuits Against Promoters

In addition to increased scrutiny by the government, investors have filed in the Northern District of Georgia two class-action lawsuits against promotors, including law firms, accounting firms, appraisers and land trusts: *Lecher et al. v. Aprio LLP, et al* and *Turk et al. v. Morris, Manning & Martin, LLP, et al*. The complaints allege that the defendants violated the Racketeer Influenced and Corrupt Organizations Act ("RICO") by developing and implementing "a fraudulent scheme to sell a flawed and defective tax-saving strategy." The alleged RICO predicate acts include the federal crimes of engaging in wire fraud, in mail fraud, and in a scheme or artifice to defraud. The complaints also allege that the defendants acted negligently, committed professional malpractice, and that certain defendants breached fiduciary duties. Plaintiffs contend that, based on "clear warnings" from the IRS, defendants were on notice that their proposed tax-saving strategy was improper, but continued to aggressively promote the strategy to investors.

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