

# Conservation Easement Cases Weave Web Of Uncertainty

By **Bill Curtis, Lauren DeSantis-Then and Bill Sanders** (November 14, 2024)

The IRS and U.S. Department of Justice are entering the new Trump administration on a high note for conservation easement tax prosecutions.

In January, the DOJ secured significant prison time for accountant Jack Fisher and attorney James Sinnott. Also of note is a key July decision by the U.S. Court of Appeals for the Fourth Circuit in *Brooks v. Commissioner*,<sup>[1]</sup> and a string of victories on value in the U.S. Tax Court against syndicated conservation easements, or SCEs.

Much of the success can be attributed to the government's focus on the "PropCo" ratio — the purchase price versus the value of the charitable deduction and allegedly fraudulent conduct.

In December 2018, the first Trump administration brought the first civil case against a promoter, EcoVest Capital Inc., alleging that the deals were "too good to be true" for investors.<sup>[2]</sup> In December 2020, the administration also secured the first guilty pleas from two Atlanta tax professionals for participating in SCEs, highlighting the investor's rate of return.<sup>[3]</sup>

The focus on the PropCo ratio started in earnest with the Feb. 24, 2022, superseding indictment related to an alleged conspiracy to design, market and sell Inland Capital SCE funds.<sup>[4]</sup> In September 2023, Fisher and Sinnott were convicted on all counts. Nine other individuals pled guilty in the case,<sup>[5]</sup> while one appraiser, Clayton Weibel, was acquitted on all counts.

Prior to the first Fisher indictment, the government's theme mainly focused on the "InvestCo" ratio, which is the ratio between each dollar invested and charitable deduction generated. For example, the IRS' Notice 2017-10 focused on an InvestCo ratio of 2.5:1 or greater.<sup>[6]</sup> Similarly, an August 2020 Senate Finance Committee report compared SCEs to cash machines for investors.<sup>[7]</sup>

The internal revenue commissioner's initial reluctance to focus on PropCo ratios may have stemmed from the Tax Court's 2009 decision in *Kiva Dunes Conservation LLC v. Commissioner*, where the court largely sided with the fund's appraiser, Claud Clark.<sup>[8]</sup>

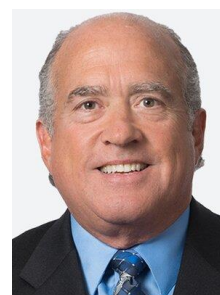
Kiva Dunes purchased the property at issue in the case in 1992 for \$1,050,000 from Resolution Trust Corp., and donated a conservation easement in 2002 over the parcel that contained an award-winning golf course. The easement allowed the golf course to continue, but restricted the right to develop high-end housing. Kiva Dunes claimed a deduction of \$30,588,235 for a PropCo ratio of 29. The government's expert valued the easement at \$10,018,000.



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The Tax Court concluded that the value of the easement was in line with Clark's appraisal and generally adopted Clark's discounted cash flow approach. Thus, an award-winning golf course received a significant deduction for agreeing to remain an award-winning golf course.

A 30-times increase in value and the ability to keep the golf course sounds too good to be true. Paraphrasing author Peter Reilly, a notable SCE critic, making sense is not a requirement for tax law, and the SCE industry took off using Kiva Dunes as the road map.[9]

Notably, the Kiva Dunes court, Clark and the commissioner's expert did not address the purchase price, quite possibly because Resolution Trust Corp. was the seller. The Kiva Dunes court considered sales of subdivided lots for the "before" value and similarly situated vacant land for the "after" value.

The first step is to determine the value of the property before the easement using the "highest and best use" and a "discounted cash flow" analysis. Conveniently, Kiva Dunes did explain how the value of the easement, a partial land interest, significantly exceeded the fee simple purchase price that included all of the interests. This resulted in values untethered to the amount funds actually paid for the property.

The 2022 indictment of Fisher highlighted the high PropCo ratio and the short time between the acquisition and donation. At this time, the focus on the PropCo ratio was not uniform in Tax Court.

For example, in 2022, in *Champions Retreat Golf Founders LLC v. Commissioner*, [10] the Tax Court largely adopted Clark's appraisal and method, while in *Brooks v. Commissioner*, [11] the Tax Court held that the value claimed by the fund's appraiser appeared incredible as a practical matter. In *Brooks*, Clark determined a fair market value for the conservation easement, a subset of property rights, nearly six times the per-acre amount for which the LLC had purchased the fee simple interest in Cotton Row Farm just 377 days earlier. [12]

After the Fisher trial, the government's focus on the PropCo ratio and inappropriate activities appears to be universal. This has led to a string of Tax Court victories on valuation. The commissioner has, however, not secured fraud penalties against an SCE in Tax Court.

First, in *Mill Road 36 Henry LLC v. Commissioner* in 2023, the commissioner sought fraud penalties for an SCE with a PropCo ratio of about 25:1. [13] The Tax Court declined to assess fraud penalties because Mill Road disclosed the "principal facts about the easement contribution." [14] Further, the promoters testified and, according to the Tax Court, were not "sharply cross-examined about income amounts or expenditures." [15]

Second, in a February decision this year, *Oconee Landing Property LLC v. Commissioner*, the commissioner did not seek fraud penalties. [16] In denying the entire deduction amount, the Tax Court found a "secret agreement" between the landowner and the appraiser that "was made for an improper purpose, i.e., to secure grossly inflated tax deductions." [17]

This parallels the allegations in Fisher, as well as the factual basis provided in an Oct. 16 guilty plea and plea agreement in *U.S. v. Bui* filed in the U.S. District Court for the Northern District of Georgia. [18] In the agreement, Vi Bui admitted that Inland Capital hired "specific appraisers ... to provide inflated appraisals consistent with predetermined target values of the land or conservation easements." [19]

Finally, in *Brooks*, the Fourth Circuit upheld in July the Tax Court's 2022 decision on valuation for a fund that had a PropCo ratio well under the ratios used in the Kiva Dunes and the Inland Capital funds. The Fourth Circuit chided Kenneth Brooks and Anita Wolke Brooks, finding their attempt to "claim a \$5.1 million deduction for a limited easement estate on property that they had purchased in fee simple for \$652,000 only a year earlier" simply did "not pass any reasonable smell test."<sup>[20]</sup>

Those who relied on Kiva Dunes, in good faith, find themselves stuck in parallel proceedings where the government looks at the PropCo ratio, which was ignored by the Kiva Dunes court, as a leading indicator of inappropriate conduct — specifically, evidence that there was an agreement to reach a predetermined value. The government looks at SCE appraisals as junk in and junk out. Kiva Dunes had a credible explanation for the increase in value; those who do not may find themselves in a situation similar to Fisher.

Further complicating the situation is the interconnected nature of the SCE vendors and promoters. In *Corning Place Ohio LLC v. Commissioner*, decided July 17, the Tax Court described "a cottage industry in Cleveland that specialized in supplying data for 'lost development rights' appraisals of historic buildings."<sup>[21]</sup>

Clark, the Kiva Dunes and Champions Retreat appraiser, appraised Corning Place, but did not testify. The court found the project "was nothing but a castle in the air ginned up to support a bogus valuation for a conservation easement."<sup>[22]</sup>

In 2023, Clark also settled a civil case brought by the first Trump administration's DOJ related to his appraisals for EcoVest, an organizer unaffiliated with Corning Place.<sup>[23]</sup> This highlights the collateral risk funds face when using vendors with significant experience valuing easements. Those vendors that were initially viewed as credible because of their experience are now under pressure because they worked on a lot of deals.

Further, new IRS regulations promulgated in August require material advisers to disclose key information.<sup>[24]</sup> Failure to file and maintain a list of reportable transactions will result in severe penalties. This "forced" disclosure of highly relevant material facts and other participants highlights the tension between disclosing the "principal facts" and pleading the Fifth Amendment in a post-Kiva Dunes landscape.

It has been a year since the Fisher trial and the DOJ has not indicted any other promoter group. The commissioner's allegations in Tax Court may provide a road map of the DOJ's next target.

The public filings in *North Donald LA Property LLC v. Commissioner*, a 2023 Tax Court case, are good examples of the risks associated with the parallel proceedings.<sup>[25]</sup> The commissioner is seeking fraud penalties. Weibel, who testified in his own defense in Fisher, pled the Fifth Amendment, as did two of the alleged promoters and North Donald's mining expert. Criminal exposure clearly continues.

What happens in Tax Court doesn't stay in Tax Court. Civil proceedings are generally stayed while criminal investigations play out, but not with SCEs. Practitioners need to be aware of the competing pressures between disclosure and the Fifth Amendment.

In *Mill Road*, the Tax Court found that credible testimony from the promoter weighed heavily against fraud; in *Oconee*, the Tax Court found collusion. The next chapter will tell us what, if anything, the IRS criminal investigation and DOJ will do with the evidence developed for Tax Court.

Adding to the web, the IRS finalized its regulations making SCEs a listed transaction on Oct. 8.[26] These regulations require participants to disclose certain information and maintain a list of reportable transactions. Failure to comply can result in draconian civil penalties, adding yet another weapon to the government's arsenal.

Going back to the original premise, the government looks at the high PropCo ratio and sees it as a significant indicator of fraud. The commissioner, for cases that make it to Tax Court, now seeks extensive discovery in order to investigate if the high values are the result of fraud. For those who participated, there is no easy answer.

The Fourth Circuit opinion in Brooks, and the Tax Court opinions, pressure the DOJ to investigate and potentially prosecute those involved in the so-called cottage industry. Audits and Tax Court proceedings can lead to criminal referrals. Yet, in Mill Road, full disclosure of the material facts thwarted the fraud penalties.

Testimony in civil cases provides the government with an opportunity to obtain testimony without providing any benefit or cooperation credit to the deponent. The risk versus reward of testifying will depend on a number of factors.

What will the next chapter bring? The new administration will inherit a backlog of SCE cases in Tax Court. Fisher and Sinnott's criminal appeal, as well as the appeals in Mill Road and Oconee, will be heard by the U.S. Court of Appeals for the Eleventh Circuit.

Many investors, vendors and promoters hope the second Trump administration will be more favorable to SCEs than the first Trump administration. There is some evidence to support this. House Republicans have called for reducing IRS funding, and the lack of funding will make it harder for the IRS to prosecute SCEs.[27]

However, the commissioner's focus on the PropCo ratio as an indicator of inappropriate activity means treacherous water ahead for participants and their advisers. Investors should also take heed and be wary of any SCE-like investments in the future.

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[1] 109 F.4th 205, 222 (4th Cir. 2024).

[2] Justice Department Sues to Shut Down Promoters of Conservation Easement Tax Scheme Operating out of Georgia, U.S. Dep't of Just.: Office of Public Affairs (Dec. 19, 2018), <https://www.justice.gov/opa/pr/justice-department-sues-shut-down-promoters-conservation-easement-tax-scheme-operating-out>.

[3] Atlanta Tax Professionals Plead Guilty to Promoting Syndicated Conservation Easement Tax Scheme Involving More than \$1.2 Billion in Fraudulent Charitable Deductions, U.S. Dep't of Just.: Office of Public Affairs (Dec. 21, 2020), <https://www.justice.gov/opa/pr/atlanta-tax-professionals-plead-guilty-promoting-syndicated-conservation-easement-tax-scheme>.

[4] Five Tax Shelter Promoters and Two Appraisers Indicted in Syndicated Conservation Easement Tax Scheme, U.S. Dep't of Just.: Office of Public Affairs (Mar. 1, 2022), <https://www.justice.gov/opa/pr/five-tax-shelter-promoters-and-two-appraisers-indicted-syndicated-conservation-easement-tax>.

[5] Atlanta Attorney Pleads Guilty in Syndicated Conservation Easement Tax Scheme, U.S. Dep't of Just.: Office of Public Affairs (Oct. 21, 2024), <https://www.justice.gov/opa/pr/atlanta-attorney-pleads-guilty-syndicated-conservation-easement-tax-scheme>.

[6] See Internal Revenue Bulletin 2017-4, IRS (Jan. 23, 2017) [https://www.irs.gov/irb/2017-04\\_IRB#NOT-2017-10](https://www.irs.gov/irb/2017-04_IRB#NOT-2017-10).

[7] Comm. on Fin. U.S. Senate, 116th Cong., Syndicated Conservation-Easement Transactions (Comm. Print 2020).

[8] T.C. Memo. 2009-145, 97 T.C.M. (CCH) 1818.

[9] See Peter Reilly, Reilly's Laws of Tax Planning (& Life!) (2023).

[10] T.C. Memo. 2022-106.

[11] T.C. Memo. 2022-122.

[12] Id. at \*22.

[13] T.C. Memo. 2023-129.

[14] Id. at \*58.

[15] Id. at \*62.

[16] T.C. Memo. 2024-25.

[17] Id. at \*44.

[18] Guilty Plea and Plea Agreement, United States v. Bui, No. 1:24-cr-00333 (N.D. Ga. Oct. 16, 2024), ECF No. 7, at 1.

[19] Id. at 8.

[20] 109 F.4th at 222.

[21] T.C. Memo. 2024-72, at \*12.

[22] Id. at \*13.

[23] See Stipulation for Entry of Final Judgment of Permanent Injunction Against Defendant Claud Clark III, *United States v. EcoVest Capital, Inc.*, No. 1:18-cv-05774 (N.D. Ga. Mar. 13, 2023), ECF No. 414.

[24] See, e.g., Highlights of Final Regulations – Section 6011, Section 6111 and Section 6112, IRS (Aug. 26, 2024), <https://www.irs.gov/businesses/highlights-of-final-regulations-section-6011-section-6111-and-section-6112>.

[25] T.C. Memo. 2023-50.

[26] See Syndicated Conservation Easement Transactions as Listed Transactions, Fed. Reg. (Oct. 8, 2024), <https://www.federalregister.gov/documents/2024/10/08/2024-22963/syndicated-conservation-easement-transactions-as-listed-transactions>.

[27] Tobias Burns, House GOP Proposes IRS Funding Cuts, Defunding Free Tax Filing System, *The Hill* (June 4, 2024), <https://thehill.com/business/4703208-house-gop-proposes-irs-funding-cuts-defunding-free-tax-filing-system/>.