

An Unwanted Visitor

What to Do If the IRS Comes Calling

by Sheila McGrory-Klyza

A visit from the IRS is not something that land trusts wish for, but that knock on the door or the ten-page document request from the IRS is an increasing reality. Because donations of conservation easements are on the rise, so too are tax deductions. Not surprisingly, this has attracted the attention of the IRS. Land trusts are now finding themselves under the microscope, and in the position of having to defend their financial controls and management accountability to the U.S. government. While far more landowners are audited each year, the number of audited land trusts has been growing—in the past year alone, approximately 10 land trusts across the country (and the Land Trust Alliance) found themselves in this situation.

“The IRS is concerned that charitable contributions are becoming the next wave of tax shelters,” says attorney Burnie Maybank of South Carolina, who is also former director of the South Carolina Department of Revenue. “It’s been looking more closely at all charitable contributions, not just land trusts.” According to Maybank, the IRS wants to make sure that land trusts are not “acting as tax shelter promoters” by allowing land to be overvalued or by not enforcing their conservation easements.

The increased audits began in Colorado, prompted by the *Washington Post* articles in 2004, Senate Finance hearings and IRS Notice 2004-41. Jay Erickson, a former trial attorney for the IRS, is now managing director of Montana Land Reliance. “In Colorado, ‘shell’ land trusts were set up by developers,” explains Erickson. “This, plus some very aggressive deductions, caused the IRS to take a hard-line approach toward land trusts.”

But Colorado attorney Bill Silberstein, who specializes in representing landowners, asserts that “the IRS has trouble distinguishing between legitimate, mainstream easements and illegitimate, fraudulent deals.” [See Silberstein’s article “Easement Audits in Colorado: What Can We Learn from Them?” in *Exchange*, Summer 2007.]



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While the Service has valid regulatory control over land trusts that hold a 501(c)(3) designation, Silberstein says that the IRS has the attitude that “people under-report their taxes and it’s their job to correct that.” He emphasizes that it is important for land trusts to “make the IRS play by the rules”; in order to do this, of course, an organization needs to know what the rules are.

more informally. However, if a formal audit is likely, then it is generally advisable to require the IRS to follow the correct procedures.

Beezley’s advice for avoiding an audit is essentially the same as his advice when facing an audit: “Have your land trust accredited and follow *Land Trust Standards and Practices*; run your organization in a professional and transparent

Know What an Auditor Looks For

Not surprisingly, poor management practices and sloppy, incomplete records stuffed in the proverbial shoebox inevitably create suspicion. Jay Erickson cites a number of other red flags that tend to attract the IRS: “A land trust needs to be careful about transactions with insiders, such as board members or major donors. In the board minutes,

“Put your organization’s best foot forward and set the framework that you are a credible organization [with] the resolve to prevail in an audit.”

Be Informed and Prepared

A huge bureaucracy with numerous divisions, the IRS can be overwhelming to deal with for any land trust, especially small ones. The pressure is magnified because the Service has the power to shut down an organization if it is declared unqualified and not abiding by the rules. So far, that scenario has not occurred, but a land trust needs to take an audit seriously. It need not, however, be intimidated. While the audit process may seem arbitrary and unreasonable, an organization’s best defense is to be informed and prepared, and have excellent records.

What are “the rules” and how can an organization best be prepared? For Allan Beezley, a land trust attorney in Colorado, rule number one is: “Be ready in case the IRS decides to drop in. You want to send them away with a good first impression. Think in advance about a strategy.” Although agents do sometimes arrive unannounced or call on the phone, a land trust may want to insist that the IRS follow proper procedures, such as issuing a formal Information Document Request. It is not necessary for a land trust to respond to informal IRS inquiries such as an unannounced visit or phone call, although in certain circumstances, in consultation with legal counsel, a land trust may want to manage the matter

manner; do a good job with public relations, outreach, and monitoring; participate in reputable state and national organizations; maintain a website showing the strengths of the organization; attract strong board members; and spend the money to hire a good lawyer.”

Because of the complexity of tax law, it is highly advisable for a land trust to retain counsel who has extensive experience in IRS audit situations. As Beezley puts it, “We’re in a very technical real estate business and it’s important to have the right advisors.” If this tactic is not feasible given the location of a land trust, however, the next best approach is to locate the most experienced tax attorney in the area.

What else can a land trust do to be prepared? Burnie Maybank suggests that an organization conduct a self audit every five years or so, or when there is a new board chair or executive director. The self audit includes checking to ensure that all the legal and organizational requirements to be a land trust are current, such as those set forth in Standard 2 of *Land Trust Standards and Practices*. This process helps to ensure that the organization is fulfilling all the requirements of a 501(c)(3). One of those requirements is being in good standing in your state, so he advises obtaining a certificate of good standing from the secretary of state.

there should be a very good reason why the deal was entered into and why it makes conservation sense. It should be clear that everyone was aware of potential conflicts of interest.” On a similar note, he cautions that “land trusts need to be careful about being accused of providing impermissible private benefit or private inurement.”

Amendments can be another red flag. “Land trusts need to be clear in their board records about why they entered into the amendment and how the change did not decrease the conservation values of the property,” says Erickson. He also stresses the importance of being thorough on IRS Form 990. “Take care to respond to each question,” he says, adding, “The Alliance’s website has a lot of good resources for help in answering 990 questions.” [See www.lta.org/policy/taxincentives/990s]

If a land trust does indeed find itself in the position of being audited, Erickson advises, “Read over the IRS request for information [Information Document Request] carefully with an attorney and make sure they aren’t looking for documents that are privileged, and that the requests are not overly vague, which could indicate ‘fishing.’” Initial contact from the Service notifying the organization of an audit may include a request for extension of the statute of limitations. The IRS has a period of three years from the date that a tax return was due or three years after

filing, whichever is later, to audit. Erickson suggests being responsive in providing the information, but he doesn't recommend providing an extension, which gives the government more time and tends to drag out the process: "It would be very unusual for me to recommend granting an extension. Three years should be enough time."

With the IRS mandate to confirm that each land trust is capable of perpetual enforcement of its conservation easements, the Service may now request that an entire landowner record be sent to the Service: all annual visit reports, approvals, interpretation letters, violations and responses, and amendments. Although the land trust is bound to meet this request, it is a good idea to consult first with the landowner and his or her attorney.

Bill Silberstein cautions land trusts, however, about unwittingly giving the IRS information that can be used against landowners and themselves: "The land trust is not legally bound to hand over certain privileged materials and, in particular cases,


it shouldn't." It is also best to provide only those items or records that are specifically referred to in the notice letter; otherwise a land trust risks opening issues unnecessarily.

Educate the IRS

Throughout the audit process, Allan Beezley emphasizes the importance of controlling the agenda through public relations: "Put your organization's best foot forward and set the framework that you are a credible organization that does quality work, has the records and systems to prove it and the resolve to prevail in an audit. Every time you do something, it's a chance to educate the IRS about how good your organization is. This can also help to redirect them to where they should be looking for fraud."

Russ Shay, director of public policy for the Land Trust Alliance, offers this advice: "Land trusts should not expect IRS agents to know very much about land trusts. IRS agents are accountants. They probably have not worked

with other land trusts. They've read the law, but haven't read anything about land conservation. That means they'll ask a lot of questions, but do not know what they're looking for. Their questions, and their reaction to your responses, may be hard to understand, because you're used to dealing with people who know what you're talking about, and have a lot of background in how land trusts work."

Not only does educating the IRS benefit an individual land trust, it can also go a long way toward helping the Service become better informed about the validity and value of conserved land. And a better informed IRS will hopefully result in a reduction of unwarranted audits of land trusts, an increased understanding of land trusts' conservation work and an enhanced ability to identify those tax schemes masquerading as conservation that all legitimate land trusts wish to see ended. 

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8 Things a Land Trust Can Do If Audited

1. Consult your land trust attorney immediately, before undertaking any response.
2. Identify state and federal government resource departments that have a stake in the success of your conservation easements. For example, the Natural Resources Conservation Service and the Farm Service Agency of the Department of Agriculture, and the U.S. Fish and Wildlife Service Partners for Fish and Wildlife may be willing to collaborate on individual state level discussions with IRS field agents.
3. Identify a consulting biologist or other relevant independent professional who can be readily available to provide evidence regarding conservation values.
4. Consult your state bar association website for audit assistance. For example in Colorado, the Colorado Coalition of Land Trusts and the Colorado Bar Association have a helpful site: www.cclt.org/policy/Federal/usefulirsinfo.html.
5. Inform the Land Trust Alliance (Russ Shay at rshay@lta.org or Lynne Sherrod at lsherrod@lta.org) of the request.
6. Seek advice from your state service center, coalition or network.
7. Maintain excellent records of essential documents without extraneous or ambiguous material in a safe storage system with back up.
8. Educate the IRS about how a credible land trust operates and what constitutes a strong conservation easement with clear public benefit.

PROTECT YOURSELF — MAINTAIN EXCELLENT RECORDS OF ESSENTIAL DOCUMENTS.