IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

UNITED STATES,	)	
	)	
Plaintiff,	)	Case No. 1:18-cv-05774-AT
	)	
v.	)	
	)	
NANCY ZAK,	)	
CLAUD CLARK III,	)	
ECOVEST CAPITAL, INC.,	)	
ALAN N. SOLON,	)	
ROBERT M. MCCULLOUGH,	)	
RALPH R. TEAL JR.,	)	
	)	
	)	
Defendants.	)	
	)	

UNITED STATES' OPPOSITION TO DEFENDANT ZAK'S MOTION TO DISMISS PURSUANT TO RULE 12(b)(6) AND RULE 9(b).

On December 18, 2018, the United States filed its complaint seeking to enjoin Defendants, including Nancy Zak, under 26 U.S.C. §§ 7402, 7407, and 7408, for their roles in the organization, promotion, and sale of the "conservation easement syndication scheme." Put simply, the "conservation easement syndication scheme," as detailed in the complaint involves Defendants selling interests in tracts of land to taxpayers looking for large tax deductions. In the arrangement, the taxpayers then get inflated appraisals of those tracts of land and

grant conservation easements on that land. The resulting inflated charitable deductions are then split among the taxpayers. The complaint articulates the steps of the scheme in much more detail, including Zak's role in the scheme. For the scheme to work, the promoters rely upon a pass-through entity and inflated appraisals of the conservation easements. Because the complaint contains 164 detailed factual allegations setting forth the "who, what, where, when and how" of Defendants' conduct as it relates to the United States' claims, including Zak's conduct, Zak's motion to dismiss should be denied.

On March 22, 2019, Defendant Zak filed a motion to dismiss Counts I, II, IV, and V with respect to her under Fed. R. Civ. P. 12(b)(6) and 9(b). (ECF No. 31, 31-1).[1] Zak wrongly paints our complaint against six defendants as some grand attack on conservation easements generally, and in doing so, impermissibly attempts to have the court consider matters outside the pleadings. Our complaint deals with the specific misconduct of six defendants who have abused the

[1] As Defendant Zak points out, Count II of the Complaint seeking an injunction under 26 U.S.C. § 7407 is directed at Defendant Clark. Because Count II does not relate to Zak and Zak is not moving to dismiss Count II, the United States will not address it in this opposition.

conservation easement deduction and violated the tax laws. But to the extent the Court takes note of Zak's facts masquerading as argument or "background" information, it seems that Congress who passed the legislation allowing conservation easements, is also concerned about such abuses.[2] Zak's motion is nothing more than an attempt to argue the merits of this case.

As alleged in the Complaint, Defendant Zak, individually and as the principal of several entities, assists in the organization, promoting and selling of conservation easement syndicates. Zak does this as a "project manager" who assists in the planning and execution of conservation easements by the syndicates. (Compl. ¶¶ 12, 64-65, 67) and by selling interests in the syndicates (Compl. ¶¶ 15, 41-42). The United States alleges that since 2009, Zak has been involved in the

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[2] *See, e.g.,* ECF No. 31-1, at 2-5, "Background") as one example of Zak's invitation to consider matters outside the Complaint. The United States *could* likewise point to a number of journal articles, investigations, and reports about the abuse of conservation easements, such as the investigation initiated on March 27, 2019 by the Senate Finance Committee, https://www.finance.senate.gov/chairmans-news/grassley-wyden-launch-probe-of-conservation-tax-benefit-abuse However, no citations to matters outside the Complaint have any "place in the Court's determination of a Rule 12(b)(6) motion which is concerned only with the legal sufficiency of the Complaint itself." *Stewart v. Quality Recovery Services, Inc.*, 2018 WL 6725553, at *5 (N.D. Ga. 2018).

organization, promotion, and sale of at least 42 different conservation easement syndicates (Compl. ¶¶ 5, 18).

As detailed in the 164 factual averments in the Complaint, the United States alleges that her conduct in organizing, promoting and selling the conservation easement syndicates– and more specifically – statements that Zak made about the availability and amount of tax benefits available to a scheme participant - is enjoinable conduct under Sections 7402 and 7408. For example, the United States alleges that Zak advises prospective customers that they can redirect some of their "tax dollars into a pre-structured Conservation Partnership" allowing them to "cut [their] taxes by 30% to 50% or more." (Compl. ¶ 120).

Zak also assured those same customers that "[the Partnership] project structure allows for the tax savings to be shared." (*Id.*). The Complaint also includes a theory as to why the United States alleges these statements – and other similar statements made by Zak – are enjoinable and/or subject to penalty and what specific facts are used to justify that theory. (Compl. ¶¶ 131-132, 134-138). Zak tries to frame this case as an attack against a "Congressionally-favored conservation activity," rather than what it truly is – a suit to enjoin Defendants from engaging in an abusive tax scheme premised on the conservation easement deduction contained in I.R.C. § 170(h).

Much like the tax shelters that have been litigated over the decades, Defendant Zak, and her codefendants, implemented an abusive scheme around a legitimate tax deduction. Zak also implies that because there is bipartisan support for the conservation easement deduction, there are benefits resulting from the deduction, and there are instances when courts resolved a challenged deduction in favor of the taxpayer, the United States' Complaint does not withstand scrutiny as a matter of law.

But the mere fact that a legitimate deduction exists and is designed to incentivize certain conduct does not require a finding that Defendants' scheme which centers on that deduction is also legitimate. *See, e.g., Sparkman v. U.S.*, 2009 WL 5103165, at *7 n.4 (D. Haw. 2009) ("Sparkman [argues] that the economic substance doctrine must be hesitantly applied in instances where state and federal legislation has purposely used tax incentives to change investor's conduct…Plaintiff is correct that Congress provided incentives for installing solar energy equipment for business purposes. However, the presence of an incentive alone does not add legitimacy to a program that in and of itself has no economic substance and is developed purely to take advantage of such an incentive.")

Likewise, Zak's analysis ignores the fact that in other instances, the partnership structure has been used in connection with an abusive tax scheme even

when the deduction or underlying transaction has substance. *See, e.g., Merryman v. Comm'r*, 873 F.2d 879, 881-883 (5th Cir. 1989) (holding partnership formed to operate oil rig lacked economic substance, though operation of oil rig itself was not a sham, in that partnership served no purpose other than to create tax benefits for its partners). In fact, many abusive tax schemes rely upon and take advantage of the partnership structure. *See, e.g., U.S. v. Heller*, 866 F.2d 1336, 1337 (11th Cir. 1989) (promoters designed a series of limited partnerships with the ostensible purpose of buying and selling shrubbery, which, if functioned as represented, would have generated tax deductions for the limited partners in excess of any cash contributions); *Bokum v. Comm'r*, 992 F.2d 1136, 1138 (11th Cir. 1993) (tax shelter took the form of a limited partnership interest in a partnership that purportedly invested in oil, gas, and mineral leases); *Feldman v. Comm'r*, 20 F.3d 1128, 1130 (11th Cir. 1994) (tax shelter took form of a limited partnership that purported to lease data processing and other equipment). There is nothing new about Defendants' scheme except that it is premised on a different deduction, the donation of a conservation easement for which a charitable contribution is claimed under 26 U.S.C. § 170.

The United States' Claims

The Complaint includes five counts: (I) injunction against all defendants under 26 U.S.C. § 7408 for engaging in conduct subject to penalty under 26 U.S.C. § 6700;[3] (II) injunction against Defendants Zak and Clark under 26 U.S.C. § 7402 for engaging in conduct subject to penalty under 26 U.S.C. § 6695A;[4]

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[3] Section 7408 grants the United States the authority to bring actions to enjoin "specified conduct." Specified conduct is defined to include conduct subject to penalty under § 6700.

The relevant portion of 26 U.S.C. § 6700 states that "any person who (1)(A) organizes (or assists in the organization of) (i) a partnership or other entity, (ii) any investment plan or arrangement, or (iii) any other plan or arrangement, or (B) participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement referred to in subparagraph (A), and (2) make or furnishes or causes another person to make or furnish (in connection with such organization or sale) (A) a statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or (B) a gross valuation overstatement as to any material matter."

[4] Section 7402 grants the district courts "jurisdiction to make and issue in civil actions, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders and processes, and to render such judgments and decrees as may be necessary **<u>or</u>** appropriate for the enforcement of the internal revenue laws." (Emphasis added).

Section 6695A(a) imposes a penalty if "(1) a person prepares an appraisal of the value of property and such person knows, or reasonably should have known, that the appraisal would be used in connection with a return or claim for refund, and (2)

(III) injunction against Defendant Clark under 26 U.S.C. § 7407 for engaging in conduct subject to penalty under 26 U.S.C. § 6694;[5] (IV) injunction against all defendants under 26 U.S.C. § 7402 for unlawful interference with the administration and enforcement of the internal revenue laws, and (V) disgorgement against all Defendants as necessary or appropriate to enforce the internal revenue laws. (ECF No. 1, at 63-73).

Thus, to prevail on its claims for an injunction, the United States will need to prove that an injunction is necessary or appropriate to enforce the internal revenue laws under § 7402 or that Defendant Zak engaged in specified conduct under § 7408, such as conduct subject to penalty under § 6700, and that an injunction is appropriate to prevent the recurrence of such conduct. 26 U.S.C. § 7408. And to prevail on its claim for disgorgement, the United States will need to prove that disgorgement is necessary or appropriate to enforce the internal revenue laws.

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the claimed value of the property on a return or claim for refund which is based on such appraisal results in a substantial valuation misstatement under chapter 1 (within the meaning of § 6662(e)), …, or a gross valuation misstatement (within the meaning of § 6662(h)), with respect to such property."

[5] As Defendant Zak excludes Count III from her motion, it is not discussed further herein.

The United States filed a complaint that includes 164 paragraphs of factual averments of conduct spanning from 2009 to present in relation to 96 conservation easement syndicates. (Compl. ¶¶ 11-174). This includes a description of all six Defendants and their roles in the conservation easement syndication scheme (*id.* ¶¶ 12-53); extensive details of how the scheme works and the steps involved in organization, promotion, and sale of each syndicate (*id.* ¶¶ 61-62); detailed examples of three different syndicates (*id.* ¶¶ 69-111); specific statements by the Defendants (*id.* ¶¶ 117-129); an identification of why certain statements were false or fraudulent and what facts Defendants knew that would have provided "reason to know" that such statements were false or fraudulent (*id.* ¶¶ 131-163).

Despite the lengthy and detailed factual averments, Zak asserts in her motion to dismiss that the complaint has not plead the circumstances of the fraud with particularity as required by Rule 9(b). However, Zak advocates for a pleading that goes beyond the requirements of Rule 9(b), essentially asking this Court to require the government to prove its case at the pleading stage. Such a requirement is inconsistent with the Federal Rules of Civil Procedure. *See, e.g., U.S. v. Prewett*, 2008 WL 840540, at *3 (M.D. Fla. 2008) ("The Complaint is not required to specify each allegedly fraudulent tax return prepared over multiple years in order to meet the requirements of Rule 9.).

The United States' Complaint alleges the circumstances of Zak's conduct with particularity. And, when taking the allegations plead in the Complaint as true, the United States has stated a plausible claim for relief. Zak's efforts to argue the merits of the case and inject facts outside the Complaint are inappropriate in deciding a Rule 12(b)(6) motion.[6] As the Complaint states a plausible claim for relief that more than satisfies Rule 9(b) and the purposes behind Rule 9(b), as outlined below, the Court should deny Zak's motion.

[6] *See, e.g.*, Argument C.2. where Zak argues that "[t]he need to dismiss Counts I and IV is underscored by the fact that courts have recognized deductions by conservation partnerships." In this section, Zak cites to three cases where partnerships claimed conservation easement deductions and implies that the existence of those cases impacts whether she is subject to penalty under § 6700. This implication is an attempt to bring in facts outside the four corners of the complaint. Whether Zak had knowledge of those cases and whether that impacted whether she had "reason to know" that her statements were false or fraudulent as it pertains to the partnership structure is not pertinent to whether the United States has stated a plausible claim for relief. *See, e.g., Stewart v. Quality Recovery Services, Inc.*, 2018 WL 6725553, at *5 (N.D. Ga. 2018).

DISCUSSION

I. The United States' Complaint Meets All Requirements for Pleading Fraud and Defendant Zak's Motion to Dismiss Should Be Denied.

A. The bar for succeeding on a Rule 12(b)(6) motion is exceptionally high.

The purpose of a Rule 12(b)(6) motion is to test the formal sufficiency of a statement of the claim for relief; the motion is not a procedure for resolving a contest between the parties about facts or the substantive merits of the plaintiff's case. *Tri-State Consumer Ins. Co., Inc. v. LexisNexis Risk Solutions, Inc.*, 823 F.Supp.2d 1306, 1316 (N.D. Ga. 2011). To avoid dismissal under Rule 12(b)(6), a complaint must include "enough facts to state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 547 (2007). The complaint must be construed liberally, and any allegations or reasonable inferences arising therefrom must be interpreted in the light most favorable to the plaintiff. *Id.* at 554-56; *Mills v. Foremost Ins. Co.*, 511 F.3d 1300, 1303 (11th Cir. 2008). A court may not go outside the pleadings when ruling on a motion to dismiss. *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1279 (11th Cir. 1999).

A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged. *Speaker v. U.S. Dep't of Health Human Servs. Centers for*

Disease Control & Prevention, 623 F.3d 1371, 80-81 (11th Cir. 2010) (internal quotation and citation omitted). The rule does not impose a probability requirement at the pleading stage, but instead simply calls for enough facts to raise a reasonable expectation that discovery will reveal evidence of the necessary element. *Id.* Motions to dismiss are generally "disfavor[ed] and rarely granted. *U.S. v. $22,010.00 in US Funds*, 2010 WL 1050410, at *2 (M.D.Ga. 2010) (denying motion to dismiss); *see also*, *Brooks v. Blue Cross and Blue Shield of Florida*, 116 F.3d 1364, 1369 (11th Cir. 1997).

B. Rules 9(b) and 12(b)(6) must be construed in accordance with the general notice pleading standard contained in Rule 8.[7]

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[7] For purposes of this opposition, the United States assumes *arguendo* that the requirements of Rule 9(b) apply to certain allegations in this case. That said, the Government need not prove fraud to obtain much of the relief it seeks. For example, 26 U.S.C. § 7402 authorizes an injunction "as may be necessary or appropriate for the enforcement of the internal revenue laws." This does not require a finding of fraud – only that the injunction is necessary or appropriate. Further, 26 U.S.C. § 7408 authorizes an injunction on showing conduct subject to penalty under a number of statutes, including § 6700 which penalizes not only intentional fraud, but also negligent or reckless falsehoods. *See, e.g., U.S. v. Pinnacle Quest Int'l*, 2008 WL 2096381, at *1 (N.D. Fla. 2008) (applying preponderance standard in § 7408 case), *aff'd*, 309 Fed. Appx. 333 (11th Cir. 2009). Section 6700 also penalizes gross valuation overstatements on a strict liability basis. *See, e.g., Autry v. U.S.*, 889 F.2d 973, 981 (11th Cir. 1989); *U.S. v. Campbell*, 704 F.Supp. 715, 726 (N.D. Tex. 1988). By its plain terms, section 6700 penalizes not only statements that a person *knew* were false or fraudulent, but also statements that a person *had reason to know* were false or fraudulent. "Reason to

Fed. R. Civ. P. 9(b) requires that "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Fed R. Civ. P. 9(b). Malice, intent, or knowledge and other conditions of a person's mind may be alleged generally. *Id.* Rule 9(b) is satisfied by identifying the specific statements, representations, or omissions; the time and place of such statement and the person responsible; the content of the statement and the person responsible; the content of the statement and how it mislead; and what the defendant obtained as a result of the fraud. *Lucky Cap. Mgmt., LLC v. Miller & Martin PLLC*, 2019 WL 855322, at *6 (11th Cir. Feb. 21, 2019) (citing *Brooks*, 116 F.3d at 1371).

The application of Rule 9(b)'s "particularity" requirement must not abrogate the concept of notice pleading. *Ziemba v. Cascade Intern., Inc.*, 256 F.3d 1194, 1202 (11th Cir. 2001); *Durham v. Business Mgmt. Assoc.*, 847 F.2d 1505, 1511 (11th Cir. 1998). Rather, Rule 9(b) is to be read in conjunction with Fed. R. Civ. P. 8(a), which requires only a "short and plain statement of the claim showing that the pleader is entitled to relief." *Brooks*, 116 F.3d at 1368, 1371.

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know" is indicative of negligence or recklessness, but not of intentional fraud. This case is not premised on a violation of 26 U.S.C. § 6701 which by its plain terms is a fraud claim that requires actual knowledge. Zak's reference to *Carlson v. U.S.*, 754 F.3d 1223, 1226-27 (11th Cir. 2014) is irrelevant. (ECF No. 31-1, at 12).

Rule 9(b) does not contain an explicit standard for determining the amount of detail of the circumstances of the alleged fraud that must be pleaded. Fed. R. Civ. P. 9(b); *Andresen v. Int'l Paper Co.*, 2014 WL 2511283, *5 (C.D. Cal. 2014) ("[A]lthough the 'who, what, when, where, and how' standard evokes the level of detail required by Rule 9(b), it does not articulate a rigid checklist."). Instead, a court should "take account of the general simplicity and flexibility contemplated by the rules" in applying the standards of Rule 9(b). *Seville Industry Mach. Corp. v. Southmost Mach. Corp.*, 742 F.2d 786, 791 (3d Cir. 1984).

The Eleventh Circuit has championed a "nuanced, case-by-case approach" for examining whether the requisite indicia of reliability to satisfy Rule 9(b) are present. *U.S. v. Crumb*, 2016 WL 4480690, at *7 (S.D. Ala. 2016) (citing *U.S. ex rel. Mastej v. Health Mgmt. Assoc., Inc.*, 591 Fed. Appx. 693, 703-04 (11th Cir. 2014)); *see also*, *U.S. ex rel. Grubbs v. Kannagnti*, 565 F.3d 180, 188 (5th Cir. 2009) ("Rule 9(b)'s ultimate meaning is context-specific, and thus there is no single construction of Rule 9(b) that applies in all contexts." (internal quotation marks and citation omitted)). What constitutes a short and plain statement must be determined in each case on the basis of the nature of the action, the relief sought, and the respective positions of the parties in terms of the availability of information

and a number of other pragmatic matters. 5B Wright & Miller, *Fed. Prac. & Proc.* § 1217 (3d ed. 2004).

This careful and flexible case-by-case analysis should also take into consideration the purposes of Rule 9(b) which include alerting defendants "to the precise misconduct with which they are charged and protecting defendants against spurious charges of immoral and fraudulent behavior." *Durham*, 847 F.2d at 1511 (internal quotation omitted). Rule 9(b) does not require the Government to *prove* its case or plead every instance of fraud that occurred when widespread fraud is alleged, such as here. *Crumb*, at *11; *Clausen*, 290 F.3d at 1313; *see also*, *U.S. ex rel. Joshi v. St. Luke's Hospital, Inc.*, 441 F.3d 552, 557 (8th Cir. 2006).

Rule 9(b)'s "particularity" standard may be applied less stringently however, when different circumstances are present, such as: (1) when the fraud allegedly occurred over a period of time, *Hill v. Morehouse Medical Associates, Inc.*, 2003 WL 22019936, at *3, n.6 (11th Cir. 2003) (citing *Fujisawa Pharm. Co. v. Kapoor*, 814 F.Supp. 720, 726 (N.D. Ill. 1993)); *Clausen*, 290 F.3d at 1314, n.25; (2) where the alleged fraud is widespread or complex, *U.S. ex rel. Butler v. Magellan Health Services, Inc.*, 101 F.Supp.2d 1365, 1368-69 (M.D. Fl. 2000); (3) when specific factual information about the fraud is peculiarly within the defendant's knowledge or control, *Hill*, 2003 WL 22019936, at *3 (and the cases cited therein); *U.S. ex rel.*

Sanders v. East Alabama Healthcare Authority, 953 F.Supp. 1404, 1413 (M.D. Al. 1996).

When these circumstances are present, Rule 9(b)'s particularity standard is relaxed. The relaxed standard permits a plaintiff to plead the overall nature of the fraud and then to allege with particularity one or more illustrative instances of the fraud. *Clausen*, 290 F.3d at 1310 (finding that the complaint may satisfy Rule 9(b) when it sets forth a representative sample detailing the defendants' allegedly fraudulent acts, when they occurred, and who engaged in them); *U.S. CFTC v. Giddens*, 2012 WL 603592, at *4 (N.D. Ga. 2012) (citing *Clausen*, 209 F.3d at 1314 n. 25); *see also*, *U.S. ex rel. Pogue v. Diabetes Treatment Ctrs. of Am., Inc.*, 238 F.Supp.2d 258, 268 (D.D.C.2002) (plaintiff need not provide a detailed allegation of all facts supporting each and every instance of fraud when fraud occurred over a period of time).

Given the circumstances of this case, the Government has plead the circumstances of Defendant Zak's alleged fraud with sufficient particularity, and, as discussed below, the Government's complaint meets even the most stringent interpretation of Rule 9(b) pleading standards.

II. The Complaint adequately alleges the "circumstances of fraud" and provide Defendant Zak with sufficient notice of the allegations of fraud made in the Complaint.

A. The United States' Complaint pleads the circumstances of fraud with particularity

In its 164 paragraphs of factual averments, the United States describes the abusive conservation easement syndication scheme that has been ongoing for more than a decade. The United States describes the general pattern of the scheme and provides illustrative examples of the scheme along with specific statements made by the different Defendants. In short, the Government's complaint articulates the *who, what, when, where and how* of Defendant Zak's false or fraudulent conduct.

1. Who

The complaint makes it clear that Defendant Zak, and the other five Defendants, are the "who" under Rule 9(b). The complaint includes details about Nancy Zak, her related entities, and her role in the conservation easement syndication scheme as a "project manager" and salesperson, (Compl. ¶¶ 12-18); outlines how Zak worked with different entities in organizing, promoting and selling conservation easement syndicates, (Compl. ¶¶ 63-65, 67); and includes details about Zak's role in two specific transactions, Partnership Z promoted and sold in 2009 (Compl. ¶¶ 69-77) and Partnership Y, promoted and sold in 2012 (Compl. ¶¶ 78-94).

2. What and How

The Complaint describes in considerable detail the mechanics of the conservation easement syndication scheme by outlining eleven distinct steps. (Compl. ¶¶ 61, 62). Then, the Complaint contains specific details of three conservation easement syndicates, including the property at issue, how the syndicates were offered, the number of units offered and the price of those units, the valuation obtained and then used to support the federal tax deductions claimed. (Compl. ¶¶ 69-111). The Complaint further articulates three categories of statements that the United States contends were false or fraudulent, why those statements were false or fraudulent, and facts known to Defendants, including Zak, that caused them to know or have reason to know that the statements were false or fraudulent. *See, e.g.,* Compl. ¶¶ 57-60, 130-138 regarding the use of a partnership and whether an investor could claim tax benefits for investing in a conservation easement syndicate organized as a partnership under federal tax law; Compl. ¶¶ 54-56, 139-141 regarding whether the conservation easements were "qualified conservation contributions", and; Compl. ¶¶ 142-163 regarding valuation statements which defendants knew or had reason to know were false or fraudulent

or otherwise constituted gross valuation overstatements.[8] All Defendants made these statements when soliciting customers and providing them with the promotional materials, including Zak. Then, in addition to identifying the three categories of false statements that were made over and over again in the organization, promotion, and sale of each conservation easement syndicate, it also identifies specific statements made by Zak. (Compl. ¶¶ 63-68, 114--122, 131-137).

3. When

The Complaint provides particularity of when Defendant Zak's conduct occurred. The Complaint alleges that Defendant Zak's conduct started no later than 2009 ***and has continued to date***. (Compl. ¶¶ 5, 12-18, 41-42, 63-68, 174). In discussing specific examples, the Complaint provides more specificity about the "when." For Partnership Z, the complaint alleges specific acts occurred between October 17, 2008 and 2010. (Compl. ¶¶ 69-77). For Partnership Y, the complaint alleges specific acts occurred 2012-2013. (Compl. ¶¶ 78-94). For Partnerships X and W, the complaint alleges specific acts by Defendants occurring between May

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[8] As noted above, if a person makes a gross valuation overstatement, § 6700 imposes strict liability on such statements. In the Complaint, the United States alleges that statements of value are gross valuation overstatements, but also that statements were false or fraudulent statements that Defendants knew or had reason to know were false or fraudulent. (Compl. ¶¶ 142-163).

18, 2015, and December 22, 2015. (Compl. ¶¶ 95-111). The Complaint also contains examples of specific statements made by Zak and includes a "when" with respect to those statements. *See, e.g.,* Compl. ¶ 118 containing a quote from her website that was last accessed on December 13, 2018; Compl. ¶ 122 excerpting a quote Zak made in promoting a conservation easement syndicate starting in December 2016.

4. Where

The complaint meets the "where" requirement for pleading fraud. The complaint contains an allegation of where Defendant Zak resides and does business (Compl. ¶¶ 12-18), where the real property subject to the conservation easements is located (Compl. ¶¶ 64, 70, 79, 97, 112), where certain of the syndicates were organized (Compl. ¶¶ 69, 78, 95, 97), and where investors were located (Compl. ¶ 113).

B. Defendant Zak cannot credibly maintain that she has an inability to understand the allegations or prepare a response.

Zak claims that it is impossible to formulate a defense to the Complaint, but her Motion actually shows the opposite. Zak has essentially formulated a defense – that what she did and said is not abusive. *See, e.g.,* ECF No. 31-1 at 18-25. Zak is essentially arguing that she did not have "reason to know" that the statements she made were false or fraudulent because case law existed to support the partnership

structure she "encouraged,"[9] that she could properly rely upon tax opinion letters obtained for the purpose of marketing the syndicates for reliance that the partnership structure and conservation easement deductions were "lawful," and that compliance with the IRS Notice also negates her "reason to know." All of these arguments go to the merits of the case and improperly attempt to inject matters outside the pleadings into the Court's consideration of a Rule 12(b)(6) motion. *See, Stewart v. Quality Recovery Services, Inc.*, 2018 WL 6725553, at *5 (N.D. Ga. 2018).

Zak attempts to bolster this argument by claiming that the Complaint lumps the Defendants together and is unclear regarding whether all the statements apply to her conduct and the syndicates with which she was involved. ECF No. 31-1, at 12-15. However, the fact that the United States alleges defendants are collectively engaging in the same conduct of each making the statements outlined in the

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[9] Zak cites to *Kiva Dunes Conserv., LLC v. Comm'r*, T.C.M. Memo. 2009-145, *Bosque Canyon Ranch II v. Comm'r*, 867 F.3d 547, 549 (5th Cir. 2017), and *Pine Mountain Pres., LLLP v. Comm'r*, 151 T.C. No. 14 (2018) to support her position. However, the mere fact that three partnerships have been able to claim deductions for conservation easements is not determinative of whether Defendants engaged in conduct that should be enjoined in this case. That is even more obvious when a reading of the cases makes it clear that the courts did not make findings about whether those partnerships were shams or lacked economic substance.

complaint – does not render the complaint deficient or make it impossible for her to formulate a defense or know of the misconduct of which the United States complains. *See, e.g., Kyle K. v. Chapman*, 208 F.3d 940, 944 (11th Cir. 2000). When reading the complaint as a whole, it is clear that the United States alleges that all Defendants are responsible for engaging in the specific conduct that the United States requests be enjoined under 26 U.S.C. §§ 7402 and 7408. While it is true that not every Defendant participated in all 96 of the transactions alleged in the Complaint, the Complaint alleges that Defendants each engaged in a pattern of conduct with respect to those transactions in which each participated as well as each Defendant's role in those transactions.

For example, Zak cites to ¶ 136 of the Complaint and claims that she does not know whether that applies to all 96 transactions or only the 54 in which Zak had no involvement. (ECF No. 31-1 at 16). However, the context of the Complaint makes it clear that these allegations apply to syndicates which were promoted by Zak, EcoVest, Solon, McCullough, and Teal. The allegation clearly references the specific Defendants, including Zak. It is not difficult for Zak to determine and thus answer whether the manager of syndicates she promoted had the ability to dispose of the land without the approval of the partners.

III. Defendant Zak's motion with respect to Count V fails because disgorgement is available under 7402 and does not violate the Excessive Fines Clause of the Eighth Amendment

Zak asks this Court to dismiss Count V because disgorgement is unavailable under *Kokesh* and 28 U.S.C. § 2462, the disgorgement count fails Rule 9(b),[10] and/or because a disgorgement claim exceeds the statutory authority under the specific penalty regime or is an excessive fine under the Eighth Amendment. Zak's analysis however, is flawed and the motion with respect to Count V should be denied. As discussed below, Section 7402 grants broad authority to this Court to find that disgorgement is necessary or appropriate in this case to enforce the internal revenue laws. *Kokesh* deals only with disgorgement in the SEC context and did not hold that disgorgement is a penalty in all contexts. As such, 28 U.S.C. § 2462 has no application in this case. Further, because disgorgement is tied to a

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[10] Zak's argument that the disgorgement claim of Count V fails Rule 9(b) is essentially a rehash of her earlier argument that the Complaint does not articulate the "who, what, where, when and how" of her fraudulent conduct and therefore cannot serve as a basis for disgorgement which also "sounds in fraud." ECF No. 31-1, at 28-29. Zak does not raise any new argument under Rule 9(b) with respect to disgorgement. The United States has already addressed this argument above and will not restate it here.

defendant's wrongful conduct, it is not an excessive fine under the Eighth Amendment.

A. 28 U.S.C. § 2462[11] does not apply to disgorgement under § 7402.[12]

Zak makes a bold assertion that disgorgement is imposed for punitive purposes. ECF No. 31-1, at 27. Zak's sole authority for this proposition is the Supreme Court's holding in *Kokesh v. S.E.C.*, 137 S. Ct. 1635, 1639 (2017). But *Kokesh* is inapposite.

In *Kokesh*, the Court considered whether disgorgement in the SEC context operates as a penalty subject to 28 U.S.C. § 2642. The Supreme Court concluded that the five-year period of limitations under § 2462 applied to disgorgement in the SEC context because it was a penalty. *Kokesh*, 137 S. Ct. at 1644. *Kokesh* did not, however, hold that disgorgement is always a penalty. *See, U.S. v. RaPower-3, LLC*,

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[11] 28 U.S.C. § 2462 states that "[e]xcept as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued…"

[12] Zak does not argue that 28 U.S.C. § 2462 applies to the injunctive relief sought, only to disgorgement. The Eleventh Circuit has held that 28 U.S.C. § 2462 does not apply to actions seeking injunctive relief. *S.E.C. v. Graham*, 823 F.3d 1357, 1362 (11th Cir. 2016); *see also*, *U.S. v. Moss*, 2017 WL 4682051, at *6 (M.D. Al. 2017). As such, the United States will confine its response to applying § 2462 with respect to the disgorgement count, Count V.

294 F.Supp.3d 1238, 1241-42 (D. Utah 2018) (*Kokesh* "decided whether disgorgement is a penalty for the purpose of applying a statute of limitation. *Kokesh* is a statutory analysis of terms. The Supreme Court does not state in *Kokesh* that its ruling determines that disgorgement is a penalty in all contexts. And, *Kokesh* certainly did not discuss or overrule the long standing precedent of categorizing disgorgement as an equitable remedy."), *appeal pending*, Nos. 18-4119, 18-4150 (10th Cir.).

In deciding whether SEC disgorgement was a penalty for purposes of 28 U.S.C. § 2462, the Court considered: (1) whether the remedy corrects an individual wrong; (2) whether the disgorgement is punitive or compensatory; and (3) whether the disgorgement is remedial in nature. *Kokesh*, 137 S. Ct. at 1643-45. All three principles support the government's position that 28 U.S.C. § 2462 is inapplicable to this case.

Generally, disgorgement is a form of "[r]estitution measured by the defendant's wrongful gain." *Kokesh*, 137 S.Ct. at 1640 (quoting Restatement (Third) of Restitution and Unjust Enrichment § 51, Comment *a*, p. 204 (2010) (Restatement Third)). But unlike the disgorgement sought in *Kokesh*, the disgorgement sought here lacks punitive characteristics. Instead, (1) this disgorgement claim redresses a wrong committed against the United States; (2) this

disgorgement claim is paid to the victim – the United States Treasury; and (3) this disgorgement claim is remedial in nature because it restores the parties to the status quo – it puts funds into the Treasury – and does so in a manner consistent with the law of restitution.[13]

The Defendants, including Zak, have caused monetary losses to the United States Treasury in the form of refunds paid or less taxes received as a result of improper tax deductions claimed by Defendants' customers. There is an articulable harm to the United States Treasury from Defendants' conduct making the United States Treasury an injured party. It is not fatal to the United States' claim that disgorgement may serve more than one purpose – in fact, disgorgement under § 7402 can be viewed as serving compensatory purposes to the United States Treasury while also serving deterrent purposes. *See Kokesh*, 137 S.Ct. at 1645; *see also, RaPower-3*, 294 F.Supp.3d at 1241 (disgorgement was compensatory because it "compensate[d] the U.S. Treasury for the millions of dollars it has lost due to

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[13] Zak attempts to diminish the value of the Eleventh Circuit's recent approval of disgorgement in *U.S. v. Stinson*, 729 Fed. App'x 891, 899 (11th Cir. 2018) because Stinson only devoted two pages of his brief to disgorgement. ECF No. 31-1, T 33, n.8. But the fact remains that the Eleventh Circuit has approved of disgorgement pursuant to § 7402 and Defendant Zak has provided no authority that overrules or disagrees with the *Stinson* analysis.

Defendants' unlawful conduct."). This analysis is also consistent with cases that discuss whether disgorgement is a "fine" under the Eighth Amendment, discussed further, *infra*.

Taking the allegations contained in the complaint as true, the United States has alleged that Defendants engaged in a pattern of conduct that resulted in more than $2 billion of improper tax deductions that were reported by the syndicates. The resulting tax harm could be in the hundreds of millions of dollars. Disgorgement is available under § 7402 as necessary or appropriate to enforce the internal revenue laws and compensate the United States Treasury for this loss caused by Defendants.[14] Because disgorgement in this case is distinguishable from *Kokesh*, the Court should conclude that § 2462 does not apply.

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[14] The Supreme Court, in *Kokesh*, noted that the government is not the victim in SEC cases yet receives disgorged funds. Further, even if the IRS were to audit Defendants' customers and able to recover some or all of the tax loss caused by Defendants, the IRS is still a victim and harmed because the IRS is forced to devote *substantial* resources to identifying Defendants' scheme and customers. *See, e.g., U.S. v. Anderson*, 2010 WL 1988100, at *3 (D.S.C. 2010); *U.S. v. Casternovia*, 2011 WL 4625638, at *7 (D. Or. 2011); *U.S. v. Grider*, 2010 WL 4514623, at *4 (N.D. Tex. 2010); *U.S. v. Ferrand*, 2006 WL 598212, at *5 (W.D. La. 2006); *U.S. v. HedgeLender, LLC*, 2011 WL 2686279, at *10 (E.D. Va. 2011).

B. The Court has authority under § 7402 to order disgorgement and the United States does not exceed its authority in requesting such disgorgement.

Zak essentially argues that the United States is inappropriately attempting to seek disgorgement in lieu of penalties imposed under § 6700. In making this argument, Zak cites to *Loving v. IRS*, 742 F.3d 1013, 1015 (D.C. Cir. 2014). However, her reliance on *Loving* is misplaced. The precise issue in *Loving* was whether the IRS's authority to "regulate the practice of representatives of persons before the Department of Treasury" encompassed the authority to regulate tax-return preparers. *Loving*, 742 F.3d at 1016. The D.C. Circuit determined that it did not. *Id.* at 1015. In contrast, this is much different. Here, § 7402 authorizes a Court to grant such orders as is necessary or appropriate to enforce the internal revenue laws and that such remedies are "in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such laws." 26 U.S.C. § 7402. *Loving*, which did not consider the remedies afforded by § 7402, is legally irrelevant to whether § 7402 authorizes disgorgement.

Zak argues that disgorgement exceeds agency authority because of the penalty regime articulated in 6700 and the basis for our injunction claim in this case in based in part on conduct alleged to be subject to penalty under § 6700. However, when the statute explicitly provides for multiple remedies, there is no

basis for Zak's claim that the government is exceeding its statutory authority. Furthermore, disgorgement as an available remedy under § 7402 does not render the penalty regime under § 6700 superfluous. First, to order disgorgement under § 7402, the Court need only find it necessary or appropriate for the enforcement of the internal revenue laws. The Court need not make specific findings of § 6700 conduct. Second, § 6700 is a civil penalty. As discussed above, disgorgement in this case is remedial or compensatory. Disgorgement and § 6700 penalties serve different purposes and therefore disgorgement does not render § 6700 superfluous.

C. Disgorgement does not violate the Excessive Fines Clause of the Eighth Amendment.

Zak cites to *Timbs v. Indiana*, a recently decided Supreme Court case to support her argument that disgorgement here would violate the Excessive Fines Clause of the Eighth Amendment. *Timbs v. Indiana*, 137 S.Ct. 682 (Feb. 20, 2019). However, the issue in *Timbs* was whether the Eighth Amendment's Excessive Fines Clause applied to a civil forfeiture under state law as well as under a civil forfeiture under federal law. The Court answered in the affirmative – but it did not determine whether the forfeiture at issue was excessive. The Supreme Court abstained for ruling on whether the forfeiture was excessive and remanded it to have the lower court consider the issue.

In determining whether a claim for disgorgement is an excessive fine in violation of the Eighth Amendment, Zak must demonstrate that disgorgement is: (1) a fine and (2) excessive. *See U.S. v. 817 N.E. 29th Drive, Wilton Manors, Fla.*, 175 F.3d 1304, 1309 (11th Cir. 1999); *U.S. v. Bajakajian*, 524 U.S. 321 (1998). A "fine" as contemplated by the Eighth Amendment is punitive in nature because at the time the Constitution was adopted, "the word 'fine' was understood to mean a payment to the sovereign as punishment for some offense." *Bajakajian*, 524 U.S. at 327 (quoting *Browning-Ferris Industries of Vt., Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 265 (1989)). To determine if a fine is excessive, the court must turn to the principle of proportionality – the amount of the fine must bear some relationship to the gravity of the offense that it is designed to punish. *Id.* at 334.

Zak's motion first presumes that disgorgement is a fine for purposes of the Eighth Amendment. But she is incorrect. As noted above, *Kokesh* does not stand for the proposition that disgorgement is always a penalty or a "fine." *See, e.g., S.E.C. v. Hall*, Civ. No. 17-13897, 2019 WL 103892, at *4 (11th Cir. Jan. 4, 2019) (quoting *Kokesh v. S.E.C.*, 137 S. Ct. 1635, 1640 (2017) (internal quotations omitted)); *see also*, *In re Bilzerian*, 153 F.3d 1278, 1283 (11th Cir. 1998); *S.E.C. v. Blackwell*, 477 F. Supp. 2d 891, 913-16 (S.D. Ohio 2007); *U.S. v. Philip Morris USA*, 310 F. Supp.2d 58, 63 (D.D.C. 2004); *cf. U.S. v. Melvin*, 2015 WL 7116737,

at *13, n.21 (N.D. Ga. 2015) ("'[T]he Excess Fines Clause does not apply to restitution or disgorgement.'") (citation omitted), *reprt. & rec. adopted*, 143 F. Supp.3d 1354 (N.D. Ga. 2015). Zak cites no other authority for her proposition.

Zak also wrongly presumes that if disgorgement is ordered, then it will be excessive because it exceeds the amount of a penalty that the IRS could assess under § 6700. However, *Timbs* does not stand for that proposition, and Zak cites nothing else to support her claim. While some courts that have considered the issue have abstained from determining whether disgorgement is a "fine," they have otherwise determined that disgorgement does not violate the Excessive Fines Clause because when disgorgement is tied to a defendant's wrongful gain, it is not disproportionate and therefore not excessive. *See, e.g., S.E.C. v. Metter*, 2017 WL 3708084, at *2 (2d Cir. 2017); *S.E.C. v. Jammin Java Corp.*, 2017 WL 4286180, at *5 (C.D. Cal. 2017); *see also*, *In re Bilzerian*, 153 F.3d 1278, 1283 (11th Cir. 1998).

IV. The United States' Complaint states a claim for relief against Zak for an injunction under 26 U.S.C. § 7402 for conduct subject to penalty under 26 U.S.C. § 6695A in Count II.

Paragraphs 193 through 195 of the Complaint allege that Zak prepared appraisals and their component parts. The explicit language of paragraphs 194 and 195 refers to the "the appraisals prepared by Zak and Clark." Despite this explicit

language, defendant Zak argues that Section 6695A only applies to persons that prepare appraisals, that she does not prepare appraisals, and the United States does not allege otherwise. (ECF No. 31-1 at 1-2, 6-9). Zak's argument focuses on the allegations in paragraph 193 that state Zak "assisted in appraising conservation easements" and "assisted in making the highest and best use determinations." Zak's argument ignores the context of the Complaint and the explicit language in the Complaint. Further, her argument attempts to attack the merits of this Count by implying that there can only be one person who prepares an appraisal and/or that a person does not "prepare" an appraisal if that person did not sign the appraisal report. But these arguments fail in light of the allegations of the Complaint – paragraph 193 is not to be considered in isolation, but in the context of the Complaint. Taking the allegations in the complaint as true and reading the complaint as a whole, which specifically references appraisals prepared by Zak, the United States has stated a plausible claim for relief on Count II. Zak's motion with respect to Count II should be denied.

Further, Count II is premised on 26 U.S.C. § 7402, which does not require a violation of a specific code section before a Court is authorized to issue an injunction. *See, e.g., Autry v. U.S.*, 889 F.2d 973, 981 (11th Cir. 1989); *U.S. v. Campbell*, 704 F.Supp. 715, 726 (N.D. Tex. 1988) ("Scienter need not be shown to

hold a person liable for gross valuation overstatements. … This 200 percent overvaluation is to be a bright line test.") (and the cases cited therein). Even if Zak's role in "assisting" in appraisals of conservation easements is found to not be conduct subject to 6695A, an injunction under 7402 with respect to the conduct as alleged may still be necessary or appropriate to enforce the internal revenue laws. Therefore, Zak's motion must be denied as the United States could succeed on Count II under the facts as alleged.

V. If the Court determines that Complaint is not plead with particularity, the United States requests leave to amend.

Where it appears a more carefully drafted complaint might state a claim upon which relief can be granted, a district court should give a plaintiff an opportunity to amend his complaint instead of dismissing it. *Bank v. Pitt*, 928 F.2d 1108, 1112 (11th Cir. 1991); *see also*, Fed. R. Civ. P. 15. Although the United States has included detailed factual averments about Defendant Zak's conduct and how her conduct violates and interferes with the internal revenue laws, if the Court finds that such allegations should be alleged with even more specificity and particularity, the United States requests leave to amend.

CONCLUSION

Because the United States' Complaint states a claim for relief on Counts I, II, IV, and V and meets the pleading requirements in the Rule, including Rule 9(b), the United States requests that the court deny Defendant Zak's motion.

Dated: April 5, 2019

Respectfully submitted,

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*I certify that this motion has been prepared with one of the font and point selections approved by the court in LR 5.1C.

CERTIFICATE OF SERVICE

I hereby certify that on April 5, 2019, the foregoing document was electronically filed with the Clerk of the Court through the CM/ECF system, which sent notice of the electronic filing to all counsel of record.

/s Erin R. Hines
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