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Abusive Tax Shelters After the Tax Reform Act of 1984

ABUSIVE TAX SHELTERS AFTER THE TAX REFORM ACT OF 1984

Tax shelters are investments that provide tax benefits to offset taxable income from other sources.[1] Congress created tax benefits within the Internal Revenue Code (I.R.C.) to encourage capital investments that help increase

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1. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 346 (revised) (1982). American Bar Association Formal Opinion 346 defines tax shelters as investments having as a significant feature deductions in excess of investment income, or tax credits in excess of income tax attributable to the investment. *Id.* The Treasury Department provides a more subjective definition of tax shelters in Circular 230, which prescribes conduct for attorneys practicing before the Internal Revenue Service (IRS). *See* 31 C.F.R. § 10.33 (1984) (Circular 230). According to Circular 230, tax shelters are investments having as a significant and *intended* feature deductions in excess of investment income, or tax credits in excess of income tax attributable to the investment. *Id.* (emphasis added); *see infra* notes 30-38 and accompanying text (explaining requirements of Circular 230 for tax attorneys). For the purpose of penalizing taxpayers who substantially understate tax liability, the Internal Revenue Code (I.R.C.) defines tax shelters as investments having as their principal purpose avoidance or evasion of federal income tax. I.R.C. § 6661(b)(2)(C)(ii) (1984). For a taxpayer to shelter income from taxation successfully, he must design a tax shelter that will provide cash income and increased asset values in excess of taxable income. *See* Davies, *An Economic Philosophy of Tax Shelters*, 29 TAX EXEC. 232 (1977) (explaining factors for evaluation of tax shelters). Tax benefits result from artificial losses such as depreciation, which investors may accelerate in the early years of investment. I.R.C. § 167 (1984) (as amended by Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, § 1064). Depreciation is an accounting method for dividing up total cost of property into an annual expense to offset income during each year of statutory or estimated useful life of the property. *Id.* Depreciation deductions reduce taxable income without cash outflow until the owner repairs or replaces the property. *Id.* Depreciation is considered an artificial loss because some property, such as real estate, actually appreciates in value, while taxpayers deduct from income amounts attributed to the property's decline in value. *See* Lischer, *Depreciation Policy: Whither Thou Goest*, 32 SW. L.J. 545 (1978) (explaining history and concepts of depreciation deductions). The Accelerated Cost Recovery System (ACRS) allows owners of depreciable business property to deduct the cost of the property over a predetermined period shorter than its useful life. I.R.C. § 168 (1984) (as amended by Tax Reform Act of 1984, §§ 12, 31-32, 111-114, 628). *Compare* Kahn, *Accelerated Depreciation—Tax Expenditure or Proper Allowance for Measuring Net Income?*, 78 MICH. L. REV. 1 (1979) (contending that accelerated depreciation accurately reflects expenditures for use of property) *with* Blum, *Accelerated Depreciation: A Proper Allowance for Measuring Net Income?!!*, 78 MICH. L. REV. 1172 (1980) (asserting that accelerated depreciation is inconsistent with concept of tax neutrality). Some tax shelters recharacterize ordinary income as tax-favored capital gains, which occur as a result of sale of a capital asset. I.R.C. § 1202 (1984). If the individual taxpayer has held an asset more than six months, he may deduct 60% of the capital gain on sale of the asset from his gross income. *Id.*; I.R.C. § 1222 (1984) (as amended by Tax Reform Act of 1984, § 1001(a)); *see* Gallagher, *Capital Gains and Losses: A Primer*, (pts. 1-2), 7 FLA. ST. U.L. REV. 1, 197 (1979) (outlining treatment of capital gains). Some tax shelters provide tax credits such as the investment tax credit to directly offset taxes owed. I.R.C. § 46 (1984) (as amended by Tax Reform Act of 1984, §§ 113, 431, 471-475). The investment tax credit allows a taxpayer to subtract 10% of the cost of a qualified investment in depreciable property, not including real property, from his tax bill. *Id.*; *see* Bradley & Oliver, *Investment Tax Credit: The Illusory Incentive*, 2 VA. TAX REV. 267 (1983) (contending that effectiveness of investment tax credit

business productivity and benefit society.[2] Tax benefits encourage investments in areas such as real property,[3] oil and gas exploration,[4] and research and development.[5] During the last twenty years, taxpayer demand for tax shelters has increased significantly.[6] In response to increased demand, investment advisers, tax consultants, and business entrepreneurs have organized and

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incentive is diminished by unclear qualification rules for property). Some tax shelters use leverage to maximize tax benefits from a minimum initial investment. In *Crane v. Commissioner*, the Supreme Court ruled that a taxpayer's basis for determining investment gains or losses is the value of the physical property itself, not the taxpayer's equity. Crane v. Commissioner, 331 U.S. 1, 6-11 (1947).

2. *See* S. REP. No. 144, 97th Cong., 2d Sess. 75-77, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 180-82 (explaining that accelerated depreciation and investment tax credits under Economic Recovery Tax Act of 1981 are intended to stimulate investments that will improve the nation's productivity in international trade); *see also* Surrey, *Tax Incentives As a Device For Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970) (examining tax incentives, such as mortgage interest deduction to encourage home ownership, rather than direct expenditures to achieve a variety of social and economic objectives); Stone, *Tax Incentives As a Solution to Urban Problems*, 10 WM. & MARY L. REV. 647 (1969) (concluding that tax incentives in the I.R.C. often are ineffective in achieving national policy).

3. *See* H. R. REP. No. 1445, 95th Cong., 2d Sess. 86-88, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 7044, 7120-22 (explaining that extension of investment tax credit under Revenue Act of 1978 to building rehabilitation should improve economic vitality of deteriorating urban areas); *see also* Note, *Tax Reform and Real Estate Tax Shelters: Consequences for Low Income Housing*, 48 U. CIN. L. REV. 99 (1979) (examining social justifications and inequities of tax incentives for low-income housing investments).

4. *See* I.R.C. §§ 611-613A (1984) (as amended by Tax Reform Act of 1984, §§ 25, 71) (authorizing annual depletion allowances for oil and gas wells); I.R.C. §§ 263(c), 291(b) (1984) (as amended by Tax Reform Act of 1984, §§ 56, 68, 712(a)) (allowing deductible expenses for intangible drilling costs). Since the 1920's Congress has provided generous tax benefits to oil and gas investors, including percentage depletion and deduction of intangible drilling costs. *See* Guerin, *Oil and Gas Taxation: A Study in Reform*, 56 DEN. L. J. 127 (1979) (evaluating effect of tax reform legislation on preferential tax treatment for oil and gas investors).

5. *See* S. REP. No. 144, 97th Cong., 1st Sess. 75-77, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 180-82 (explaining that Congress intended substantial tax credits under Economic Recovery Tax Act of 1981 for research and development expenses to encourage expansion of research programs); *see also* Note, *Tax Analysis of Research and Development Limited Partnerships*, 41 WASH. & LEE L. REV. 307 (1984) (examining tax treatment of limited partnership tax shelters for research and development programs).

6. *See* Robert A. Stanger & Co., *The Stanger Report* 11-12 (February 1984). According to Stanger's tax shelter industry newsletter, taxpayer investment in publicly registered tax shelters was approximately $4.9 billion in 1981, $5.5 billion in 1982, and $8.4 billion in 1983. *Id.* Investment in publicly registered tax shelters for the first half of 1984 was $4.1 billion, an increase of 5% over 1983's record-setting pace. Robert A. Stanger & Co., *The Stanger Report* 11-12 (August 1984). In addition to the demand for tax shelters subject to securities registration, the demand for private unregistered tax shelters has increased. According to one estimate, investment in private unregistered tax shelters will be $10.5 billion in 1984. Dentzer, *How Americans Beat The Tax Man*, Newsweek, April 16, 1984, at 59. In formulating the Tax Reform Act of 1984, Congress suggested that the increased demand for tax shelters is due to a rapid increase in marginal tax rates for each additional dollar earned by taxpayers, high interest rates, an overload of available tax deductions and credits, and a decline in the IRS audit rate. STAFF OF JOINT COMMITTEE ON TAXATION, 98th Cong., 2d Sess., PROPOSALS RELATING TO TAX SHELTERS

promoted investments designed specifically as tax shelters.[7] Investments designed as tax shelters often provide tax benefits on a wide scale for large groups of investors.[8]

Tax shelter organizers and promoters earn fees from each taxpayer who purchases an interest in the tax shelter.[9] Most tax shelter organizers and promoters design investments that combine economic, societal, and tax benefits.[10] Economic benefits such as property appreciation make investments profitable for investors regardless of their tax benefits.[11] In addition, tax shelters may provide societal benefits such as improving business productivity, which helps improve the nation's standard of living.[12]

Some tax shelter organizers and promoters, however, sell "abusive" tax shelters designed only to generate tax benefits for investors.[13] Abusive tax shelters provide little or no economic and societal benefits.[14] Abusive tax shelters generally involve fraudulent investments in nonexistent or grossly

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AND OTHER TAX-MOTIVATED TRANSACTIONS, 10-11 (1984) [hereinafter cited as JOINT COMMITTEE PROPOSALS].

7. JOINT COMMITTEE PROPOSALS, *supra* note 6, at 10. According to the Joint Committee, the supply of tax shelters has increased because many asset users can take advantage of tax deductions and credits only if they lease from tax shelter partnerships. *Id.* The Joint Committee also suggested that the increasing supply is due to high interest rates and increasing complexity of the tax laws. *Id.*

8. *See* Sax, *Lawyer Responsibility in Tax Shelter Opinions*, 34 TAX LAW. 5, 6, 9 (1980) (describing public sales of tax shelter interests by mass merchandizing).

9. *See* Wassenaar, *Abusive Tax Shelters: "Too Good to be True,"* 15 TAX ADVISER 427, 428 (1984) (explaining that tax shelter promoters generally charge investors between 6% and 10% of the amount of tax deductions provided). Under I.R.C. §6700, the term "tax shelter promoter" includes any person who assists in the organization or marketing of a tax shelter. I.R.C. § 6700(a) (1984). The term "tax shelter organizer," according to I.R.C. section 6111, includes the principal organizer who discovered or created the tax shelter, and others who participate in the organization or management of the tax shelter. I.R.C. §6111(d) (1984).

10. *See* Stanger, *Tax Shelters*, 123 TR. & EST. 10, 12 (1984) (suggesting that 95% of all tax shelters on the market comply with I.R.C. provisions and congressional intent to encourage investments that will benefit society).

11. *See id.* In his discussion of tax shelters, investment authority Robert A. Stanger concluded that rates of return for many real estate tax shelters before and after taxes are virtually identical. *Id.* Consequently, Stanger encouraged taxpayers to focus on economic gains from the investment rather than only on tax loss characteristics. *Id.*

12. *See supra* note 2 and accompanying text (explaining incentives in form of tax benefits that will improve business productivity or help improve nation's standard of living).

13. *See* Egger, *Warning: Abusive Tax Shelters Can Be Hazardous*, 68 A.B.A. J. 1674 (1982). IRS Commissioner Roscoe L. Egger defines abusive tax shelters as investments that lack economic reality and involve overvalued assets or unrealistic allocations. *Id.* In contrast, non-abusive tax shelters have legitimate economic benefits which outweigh tax benefits. *Id.*

14. *See* JOINT COMMITTEE PROPOSALS, *supra* note 6, at 13. Tax shelter investment incentives often distort investment strategy, promote inefficient economic activity, and impair the fairness of the tax system. *Id.* According to Congress, the growth of tax shelters "feeds on itself" and "the tax burden falls increasingly on taxpayers who do not or cannot take advantage of tax shelters." *Id. Compare* note 2 and accompanying text (explaining congressional intent to encourage investments that improve business productivity or help improve nation's standard of living) *with* Shine, *Exotic Tax Shelters Compared with Real Estate, the King of Shelters*, 37 N.Y.U. INST. FED. TAX'N § 9 (1979) (examining questionable justifications for tax shelters in

and intentionally overvalued assets.[15] Although the I.R.C. does not specifically define abusive tax shelters, the Internal Revenue Service (IRS) does not allow investors to realize tax benefits from fraudulent investments or investments designed solely for tax benefits rather than for economic benefits.[16]

Beginning in the late 1960's, Congress enacted a series of tax reforms designed to curb perceived tax shelter abuses.[17] Despite the legislative restric-

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areas such as motion pictures which do not affect nation's productivity).

15. *See* Wassenaar, *Abusive Tax Shelters: "Too Good To Be True,"* 15 TAX ADVISER 427 (1984) (suggesting that many abusive tax shelters involve fraudulent investments in non-existent or grossly and intentionally overvalued assets); *see also* Zobel & Shore, *The IRS Crackdown on Valuation Abuses: How Far Does It Go; What Does it Portend?*, 52 J. TAX'N 276 (1980) (describing abuses in overvaluation of art investments).

16. I.R.C. § 165(c)(2) (1984). *See* Brannen v. Commissioner, 722 F.2d 695, 704-05 (1984) (tax deductions disallowed because investment in unmarketable movie was not intended for profit but solely for purpose of avoiding tax liability); Rice's Toyota World, Inc. v. Commissioner, 81 T.C. 184, 202-10 (1983) (tax benefits disallowed because investment in computer equipment for leaseback was not intended for any business purpose other than tax avoidance); Siegel v. Commissioner, 78 T.C. 659, 686-91 (1982) (IRS disallowed tax deductions that were based on grossly inflated value for motion picture investment).

17. *See* Pub. L. No. 91-172, 83 Stat. 487 (Tax Reform Act of 1969); Pub. L. No. 92-178, 85 Stat. 497 (Revenue Act of 1971); Pub. L. No. 94-455, 90 Stat. 1520 (Tax Reform Act of 1976); Pub. L. No. 95-600, 92 Stat. 2763 (Revenue Act of 1978); Pub. L. No. 97-34, 95 Stat. 172 (Economic Recovery Tax Act of 1981). The Tax Reform Act of 1969 imposed a minimum tax on individuals who used certain tax preferences such as accelerated depreciation, restricted recapture of real estate losses, restricted accelerated depreciation on real estate, and limited deductibility of interest. Pub. L. No. 91-172, 83 Stat. 487 (1969) (codified as amended in scattered sections of 26 U.S.C.). Two years later, Congress promulgated the Revenue Act of 1971, which reinstated the investment tax credit but imposed limitations on its availability. Pub. L. No. 92-178, 85 Stat. 497 (1971) (codified as amended in scattered sections of 26 U.S.C.).

The Tax Reform Act of 1976 imposed an "at risk" limitation on nonrecourse debt for investments, limited prepaid expense deductions, and limited the use of partnerships for tax-motivated transactions. Pub. L. No. 94-455, 90 Stat. 1520 (1976) (codified as amended in scattered sections of 26 U.S.C.). The "at risk" limitation prohibits tax deductions for losses in excess of the amount that the investor could lose if the investment failed. I.R.C. § 465 (1984) (as amended by Tax Reform Act of 1984, § 432). The Revenue Act of 1978 expanded the "at risk" limitations to cover all investments except real property. Pub. L. No. 95-600, 92 Stat. 2763 (1978) (codified as amended in scattered sections of 26 U.S.C.). The Economic Recovery Tax Act of 1981 (ERTA) lowered the maximum individual tax rate from 70% to 50%, imposed a penalty when overvaluation of property results in tax underpayment, and added an "at risk" limitation on the investment tax credit. Pub. L. No. 97-34, 95 Stat. 172 (1981) (codified as amended in scattered sections of 26 U.S.C.). ERTA also enacted the Accelerated Cost Recovery System (ACRS) which encouraged tax shelters because investors could deduct larger depreciation expenses earlier in the life of the investment. *Id.*

For analysis of each tax reform act, *see* Kubik, *The Tax Reform Act of 1969: Its Effect on Real Estate Depreciation, Sales of Certain Low-Income Housing Projects, Earnings and Profits, Investment Credit, Individuals' Taxes, and Administrative Provisions*, 19 U. KAN. L. REV. 1 (1970) (explaining Tax Reform Act of 1969); Tomasula & Emory, *Revenue Act of 1971 Makes Significant Changes to Many Parts of Code*, 36 J. TAX'N 66 (1972) (analyzing Revenue Act of 1971); Lee, *Tax Shelters Under the Tax Reform Act of 1976*, 22 VILL. L. REV. 223 (1977) (explaining rules for tax shelters under the Tax Reform Act of 1976); Klein, *Coping With the At-Risk Rules: Planning Opportunities Suggested By the 1978 Act*, 51 J. TAX'N 22 (1979) (analyzing effect of Revenue Act of 1978); Briner, *Economic Recovery Tax Act of 1981*, 15 AKRON L. REV. 325 (1981) (describing ERTA).

tions imposed by Congress, the use of tax shelters continued to grow.[18] The IRS discovered an increasing number of abusive tax shelters in audited returns.[19] In 1982, Congress concluded that promoters of abusive tax shelters were more culpable of tax abuse than investors.[20] Congress also concluded that securities laws did not effectively deter promoters of abusive tax shelters.[21] As a result, Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA),[22] which authorized civil penalties and injunctions against abusive tax shelter promoters.[23]

Despite the enactment of TEFRA, the backlog of audited tax returns in which investors claimed tax benefits from abusive tax shelters continued to grow.[24] To prevent promotion of abusive tax shelters, the IRS implemented a nationwide program to identify abusive tax shelters before audit of investors' returns.[25] Under the abusive tax shelter identification program, the

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18. *See supra* notes 6-7 and accompanying text (describing increasing use of tax-sheltered investments).

19. *Compare* Egger, *Warning: Abusive Tax Shelters Can Be Hazardous*, 68 A.B.A. J. 1674, 1676 (1982) (indicating that only 400 tax shelter cases were under investigation in 1974) *with* Wassenaar, *Abusive Tax Shelters: "Too Good to be True,"* 15 TAX ADVISER 427, 429 (1984) (approximately 350,000 tax returns were under examination for tax shelter-related issues in 1984). In addition to the tax shelters under IRS examination, approximately 20,000 of the 60,000 cases currently on the Tax Court docket involve tax shelters. *Id.* According to a congressional committee, the 20,000 tax shelter cases on the Tax Court docket represent asserted tax deficiencies of $1.4 billion, or an average of $70,000 per case. JOINT COMMITTEE PROPOSALS, *supra* note 6, at 7. Although tax shelter cases represented only 7% of cases examined by the IRS in 1983, they accounted for 46% of total recommended taxes and penalties. *Id.*

20. *See* S. REP. No. 494, 97th Cong., 2d Sess. 266, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 781, 1014 (concluding that IRS should attack abusive tax shelter organizers and promoters because they are source of abusive tax shelters).

21. *See id.* In 1982 Congress recognized that Securities and Exchange Commission (SEC) registration rules and penalties deterred some abusive tax shelter promoters, but IRS enforcement was needed to solve the abusive tax shelter problem. *Id.*; *see infra* notes 54-55 and accompanying text (explaining applicability of securities registration rules to tax shelters).

22. Pub. L. No. 97-248, 96 Stat. 324 (Tax Equity and Fiscal Responsibility Act of 1982) (codified as amended in scattered sections of 26 U.S.C.).

23. *Id.* The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) authorized penalties and injunctions against abusive tax shelter promoters and penalties against taxpayers who substantially understate their taxes. *Id.* TEFRA also imposed a penalty against persons who aid and abet understatement of tax liability and increased the interest rate charged for tax payment deficiencies. *Id.* In addition, TEFRA authorized tax audits at the partnership level. *Id.*; *see* Note, *Abusive Tax Shelters: Will the Latest Tools Really Help?*, 57 S. CAL. L. REV. 431 (1984) (explaining TEFRA); *see also* Martin, *An Analysis of the Impact of the New Tax Legislation on the Use of Tax Shelters*, 57 J. TAX'N 288 (1982) (same).

24. *See* S. REP. No. 169, 98th Cong., 2d Sess. 430 (1984) (at end of 1982, 285,000 tax shelter investor returns were under IRS examination and 53,440 cases were pending in Tax Court); *see also* Wassenaar, *Abusive Tax Shelters: "Too Good to be True,"* 15 TAX ADVISER 427, 429 (1984) (by July 1984, approximately 350,000 tax shelter returns were under IRS examination and approximately 60,000 cases were pending in the Tax Court). Of total cases pending in the Tax Court, approximately one-third involved tax shelters. *Id.*

25. Rev. Proc. 83-78, 1983-2 C.B. 595 (1983). In 1973 the IRS began a national program to identify abusive tax shelters in the oil and gas industry. *See* Kurtz, *Commissioner's Remarks on Abusive Tax Shelter Issues*, 55 TAXES 774, 774-75 (1977) (explaining IRS plans to combat

IRS first reviewed tax shelter promotional material and evaluated the likelihood of tax abuse.[26] If the investigation indicated tax abuse was likely, the IRS scheduled a meeting with the tax shelter promoter.[27] After the meeting, the IRS decided whether to seek a penalty or injunction against the promoter.[28] If the IRS determined that the tax shelter was abusive, the IRS notified investors that they would disallow tax benefits from the tax shelter.[29]

While tax reforms and investigations targeted abusive tax shelter organizers and investors, the Treasury Department also focused on attorneys who wrote tax shelter opinions.[30] A tax shelter opinion is an attorney's legal advice concerning the tax aspects of a tax shelter.[31] The written opinions are directed to potential investors who may rely on the attorney's advice in

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abusive tax shelters). The IRS then expanded the program by including abusive tax shelters in real estate, motion pictures, and farming. *Id.* In October 1983, the IRS revised its abusive tax shelter identification program to improve identification procedures and prevent creation of abusive tax shelters. Rev. Proc. 83-78, 1983-2 C.B. 595, 596 (1983).

26. Rev. Proc. 83-78, 1983-2 C.B. 595, 596 (1983). *See* Philip Coates, Associate IRS Commissioner, Remarks at the 1983 AICPA Tax Section Meeting, *reported in* Daily Tax Report (BNA) 240, at G-6 (December 13, 1983) (explaining that constraints on IRS resources permit investigation of only clearly abusive tax shelters and not marginally abusive tax shelters).

27. Rev. Proc. 83-78, 1983-2 C.B. 595, 596 (1983).

28. *Id.*; *see infra* notes 86-96 and accompanying text (explaining penalty and injunction provisions against promoters of abusive tax shelters).

29. Rev. Proc. 83-78, 1983-2 C.B. 595, 597 (1983). The IRS may send pre-filing notification letters to investors in abusive tax shelters advising that tax benefits are not allowable and that the IRS may assess penalties if investors claim such benefits on their tax returns. *Id.* Alternatively, the IRS may send notification letters after investors have filed their returns, advising investors to file amended returns. *Id.*; *cf.* Mid-South Music Corp. v. United States, 83-2 U.S.T.C. ¶ 9710 (M.D. Tenn. 1983) (injunctions against promoters and letters to investors upheld as appropriate remedies for abusive tax shelters).

30. *See* Robert H. Mundenheim, General Counsel of the Treasury, Address before the Securities Regulation Institute in San Diego, California on Jan. 18, 1980, *reprinted in* Daily Tax Report (BNA), at J-1 (Jan. 22, 1980). In January 1980, the Treasury Department expressed concern about legal opinions on tax shelters and asked for response from the tax bar. *Id.* In September 1980, the Treasury Department issued proposed amendments to Circular 230, which prescribes conduct for attorneys practicing before the IRS. 45 Fed. Reg. 58594 (1980). The legal community objected to the broad scope and vague definitions in the original proposed amendments. *See* Section of Taxation, American Bar Association, *Statement on Proposed Rule Amending Circular 230 With Respect to Tax Shelter Opinions*, 34 TAX LAW. 745 (1981) (asserting that the proposed rules were not appropriate). In June 1981, the ABA responded to the Treasury Department's amendments with original Formal Opinion 346, which, like Circular 230, prohibited "negative" opinions on the allowability of tax deductions. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 346 (1981). "Negative" opinions state that the investor is not likely to realize certain tax benefits if the IRS challenges those benefits. *Id.* The ABA's original opinion 346 provoked adverse comments and suggested modifications from the legal community, so the ABA revised opinion 346 to permit "negative" tax shelter opinions, and reissued final opinion 346 in January 1982. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 346 (1982) (revised). After the ABA issued final opinion 346, the Treasury Department revised the proposed amendments to Circular 230, clarified the language, and permitted "negative" opinions. 47 Fed. Reg. 56144 (1982).

31. *See* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 346 (revised) (1982) (defining term "tax shelter opinion" and providing ethical standards for preparation of

evaluating a tax shelter.[32] In February 1984, the Treasury Department in Circular 230 issued new standards for attorneys who provide tax shelter opinions after May 23, 1984.[33] Circular 230 prescribes conduct for attorneys practicing before the IRS.[34] Under previous standards, attorneys needed only a "reasonable basis" for stating that tax benefits offered in a tax shelter were legitimate.[35] The new Circular 230 standards prohibited "reasonable basis" opinions because some opinions misinterpreted the law.[36] For example, some tax shelter opinions only sought to protect investors in abusive tax shelters from negligence or fraud penalties.[37] Under the new Circular 230 standards, attorneys who write tax shelter opinions must inquire into all relevant facts, identify representations concerning future activities of the investment, identify assumed facts, consider all material tax issues, and address all tax issues that the IRS might challenge.[38] Finally, the new standards require opinion writers to state, if possible, whether the IRS will allow investors to shelter other taxable income with each tax benefit included

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tax shelter opinions); *see also* 31 C.F.R. § 10.33(c)(3) (1984) (defining tax shelter opinion for requirements under Circular 230). *See generally* Sax, *Lawyer Responsibility in Tax Shelter Opinions*, 34 TAX LAW. 5 (1980) (explaining why tax shelter organizers and promoters hire attorneys to write shelter opinions).

32. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 346 (revised) (1982). Taxpayers are more likely to invest in a particular tax shelter if an attorney is associated with the investment. *See* 45 Fed. Reg. 58594 (1980) (explaining reason for adoption of tax shelter opinion rules).

33. 31 C.F.R. § 10.33 (1984) (Circular 230). Attorneys who fail to meet the new Treasury Department Circular 230 standards for writing tax shelter opinions face possible disbarment from practice before the IRS. 31 C.F.R. § 10.52 (1984); *see* Falik, *Standards For Professionals Providing Tax Opinions in Tax Shelter Offerings*, 37 TAX LAW. 701 (1984) (comparing final Circular 230 and ABA Formal Opinion 346); *see also* Schlenger & Watkins, *Exploring the Myths of Circular 230*, 62 TAXES 283 (1984) (discussing tax attorney's objections to Circular 230).

34. 31 C.F.R. §§ 10.0-10.93 (1984).

35. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 314 (1965). ABA Formal Opinion 314, previously the only guideline for tax shelter opinions, allows an attorney to take the facts concerning tax liability as he finds them and claim a position on an IRS return most favorable to the taxpayer, so long as there is a "reasonable basis" for the position. *Id.*

36. *See* Robert H. Mundenheim, General Counsel of the Treasury, Address before the Securities Regulation Institute in San Diego, California on Jan. 18, 1980, *reprinted in* Daily Tax Report (BNA), at J-1 (Jan. 22, 1980) (expressing concern about tax shelter opinions which rely on "reasonable basis" standard, assumed facts, or false statements). In addition to prohibiting "reasonable basis" opinions, the Treasury intended Circular 230 to stop false opinions, "assumed facts" opinions, and opinions which did not relate the law to the actual facts. *Id.*

37. *See* Sax, *Lawyer Responsibility in Tax Shelter Opinions*, 34 TAX LAW. 5, 14 (1980). Some tax shelter investors knew their investments might be abusive but nevertheless relied on attorneys' false or "reasonable basis" opinions to protect themselves from all penalties except for interest on any tax underpayment discovered by the IRS. *Id.*

38. 31 C.F.R. § 10.33 (1984); *see* Goldfein & Cohn, *Final Circular 230 Amendments Prescribe Disciplinary Standards for Shelter Opinions*, 60 J. TAX'N 330 (1984) (explaining requirements under Circular 230 for tax professionals who provide tax shelter opinions).

in the tax shelter, and with all tax benefits combined in the tax shelter.[39]

In 1984, Congress determined that existing investigative and audit procedures were inadequate to detect many abusive tax shelters.[40] Congress recognized that investors in abusive tax shelters earned profits from deferral of tax liability while the IRS searched for returns from investors in the same or similar tax shelters.[41] Congress also concluded that existing penalties were inadequate to deter abusive tax shelter organizers, promoters, and investors.[42] As a result, Congress enacted the Tax Reform Act of 1984 (1984 Act),[43] which requires registration of tax shelters.[44] In addition, the 1984 Act requires

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39. 31 C.F.R. § 10.33 (1984); *see* Hobbet, *Estimating the Risk of Failure When a Tax Shelter Investment Is Being Evaluated*, 61 J. TAX'N 74 (1984) (outlining system for determining whether tax shelter investors will more likely than not receive tax benefits).

40. *See* H. R. REP. No. 432, 98th Cong., 2d Sess. 1351, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 3, 310 (suggesting that tax shelter promoters and investors profit because the IRS is unable to examine every return effectively). The IRS audit rate decreased from 2.11% of all individual income tax returns in 1979 to 1.50% in 1983. JOINT COMMITTEE PROPOSALS, *supra* note 6, at 7.

41. H. R. REP. No. 432, 98th Cong., 2d Sess. 1351, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 3, 310. During audits and investigations of tax abuse, the IRS searches for all returns in the same tax shelter in order to determine tax liability for all investors at the partnership level. *See* I.R.C. § 6221 (1984) (authorizing determination of tax treatment at partnership level rather than for each taxpayer). The Tax Court, in an effort to reduce the backlog of tax shelter-related cases, recently experimented with a system of grouping cases involving similar tax shelters and hearing only a few test cases that will dispose of the others in the grouping. *See* Pike, *Tax Court's New Tack On Its Shelter Backlog*, NAT'L LAW J., March 12, 1984, at 38 (describing Tax Court's system for grouping cases involving similar tax shelters).

42. *See* S. REP. No. 169, 98th Cong., 2d Sess. 434-36 (1984) (concluding that existing penalities against abusive tax shelter promoters and interest penalties on tax underpayments were inadequate in amount).

43. Pub. L. No. 98-369, 98 Stat. 495 (Tax Reform Act of 1984) (codified as amended in scattered sections of 26 U.S.C.). Congress designed the Tax Reform Act of 1984 (1984 Act) as part of a deficit reduction package of tax reforms and spending cuts. *See* H. R. REP. No. 432, 98th Cong., 2d Sess. 1094-1111, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 3,76-92. The purpose of the 1984 Act was to reduce the federal deficit, prevent tax base erosion, improve tax equity, improve administration and simplification of the tax system, provide incentives for investment and continued economic growth, and reduce federal spending. *Id.* For commentary about the impact of the 1984 Act on tax shelter accounting, *see* Martin, *Tax Shelter Accounting Under the New Law: An Analysis of A Dramatically Changed Area*, 61 J. TAX'N 170 (1984) (explaining 1984 Act's prohibition of tax deductions taken any earlier than receipt of economic performance); *see also* Larason & Morgan, *Many Partnership Planning Opportunities Restricted by Deficit Reduction Act of 1984*, 13 TAX'N LAW. 74 (1984) (explaining 1984 Act's requirements regarding allocation of tax deductions between partners based on value of contributed property). *See generally* Green, *Highlights of the Deficit Reduction Act of 1984*, 15 TAX ADVISER 514 (1984) (explaining tax effects on individuals under Tax Reform Act of 1984).

44. I.R.C. § 6111 (1984) (added by Tax Reform Act of 1984, § 141) (tax shelter registration requirement); *see infra* notes 47-73 and accompanying text (discussing tax shelter registration rules).

promoters to provide lists of tax shelter investors,[45] and increases penalties for abusive tax shelters.[46]

The 1984 Act requires tax shelter organizers to register tax shelters with the IRS before organizers offer interests for sale.[47] In defining tax shelters, the 1984 Act introduces the term "tax shelter ratio."[48] The 1984 Act defines the tax shelter ratio as the ratio of tax benefits to the amount invested by a taxpayer at the end of any of the tax shelter's first five years.[49] Under the 1984 Act, new I.R.C. section 6111 specifically requires registration of investments having tax shelter ratios greater than two to one for any investor in any of the first five years of the investment.[50] For the registration rules to apply, a tax shelter organizer need not explicitly represent a tax shelter ratio as greater than two to one.[51] Instead, the 1984 Act requires registration if persons may "reasonably infer" from the tax shelter organizer's representations made in the offering that the tax shelter ratio exceeds two to one.[52]

Under the 1984 Act, any investment having a tax shelter ratio over two to one qualifies for registration only if it is a "security" or a "substantial

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45. I.R.C. § 6112 (1984) (added by Tax Reform Act of 1984, § 142) (tax shelter investor list requirement); *see infra* notes 74-79 and accompanying text (explaining requirement for lists of tax shelter investors).

46. I.R.C. § 6700 (1984) (amended by Tax Reform Act of 1984, § 143) (abusive tax shelter promoter penalty); I.R.C. § 6659 (1984) (amended by Tax Reform Act of 1984, § 155) (taxpayer penalty when property overvaluation results in tax underpayment); I.R.C. § 6621(d) (1984) (amended by Tax Reform Act of 1984, § 144) (assessing interest penalty on taxpayers who substantially understate tax liability); I.R.C. § 6601 (1984) (amended by Tax Reform Act of 1984, § 158) (prescribing time period for computation of interest penalty); *see infra* notes 80-120 and accompanying text (outlining increased penalties against promoters and investors in abusive tax shelters).

47. I.R.C. § 6111 (1984) (added by Tax Reform Act of 1984, § 141).

48. I.R.C. § 6111(c) (1984).

49. *Id.* For the purpose of computing the tax shelter ratio, tax benefits are the total of gross tax deductions and 200% of tax credits represented as potentially allowable for any investor for all years up to and including the current year. *Id.* The amount invested by the taxpayer is the total of cash and other property contributed, reduced by any liability to which such other property is subject. *Id.* The investment base does not include loans from other parties participating in the organization, sale or management of the investment unless the loan must be repaid before the end of the year. *Id.* The investment base also does not include amounts held by the tax shelter as cash equivalents or marketable securities. *Id.*

50. *Id.* The tax shelter organizer must determine if the maximum tax shelter ratio for any single investor exceeds 2 to 1. *Id.* In computing the maximum tax shelter ratio, all persons with interests in the investment are considered investors, except general partners in a limited partnership whose aggregate interest in partnership income, loss, or deductions does not exceed two percent. Treas. Reg. § 301.6111-1T (amended), T.D. 7990, 1984-48 I.R.B. 17 (October 26, 1984).

51. Treas. Reg. § 6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 11 (August 13, 1984).

52. I.R.C. § 6111(c)(1)(A) (1984). Under the 1984 act, "offerings" of tax shelter interests are not limited to the meanings of "offerings" under securities laws, but also include less formal arrangements such as oral representations. H. R. REP. No. 861, 98th Cong., 2d Sess. 980, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 751, 974. *See infra* notes 132-133 and accompanying text (explaining why tax shelter organizers may have difficulty applying standard for registration of tax shelters).

investment."[53] According to section 6111, the IRS considers a tax shelter interest a "security" if it is subject to securities registration with the Securities and Exchange Commission (SEC) or a state securities agency.[54] Alternatively, a tax shelter interest is considered a security if the organizer must file notice with the SEC or a state securities agency pursuant to securities registration exemptions.[55] If an investment having a tax shelter ratio over two to one is not a security, it qualifies for tax shelter registration under the 1984 Act if

53. I.R.C. § 6111(c) (1984).

54. I.R.C. § 6111(c)(1)(B)(i) (1984). Investments subject to tax shelter registration include those that must register with the SEC under the Federal Securities Act of 1933 (1933 Act). 15 U.S.C. §§77a-77aa (1982). Congress designed the 1933 Act to give investors full information on which to base their investment decisions and to protect investors from fraudulent investment offerings. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194-95 (explaining purpose of 1933 Act), *reh'g denied*, 425 U.S. 986 (1976). The 1933 Act defined the term "security" to include investment contracts and profit-sharing agreements. 15 U.S.C. § 77b(1) (1982). Accordingly, limited partnership interests offered to the public, such as oil drilling tax shelter interests, are defined as securities and must register with the SEC. *See* Kennedy, *Problems Faced By the Tax Adviser in Registration of Tax Shelter Securities with the SEC*, 33 N.Y.U. Inst. Fed. Tax'n 1365 (1975) (explaining federal securities registration of limited partnership tax shelters); *cf.* Russo, *Rule 10b-5 Litigation and Tax Shelter Investments*, 10 Sec. Reg. L.J. 339 (1983) (examining liabilities of tax shelter organizers and tax attorneys who file fraudulent securities registration statements). In contrast, general partnership investment interests generally are not securities. *See* Williamson v. Tucker, 645 F.2d 404, 419-25 (5th Cir.) (en banc) (distinguishing limited partners from general partners who lead active roles in management of their investment, have access to information, and do not need protection provided by 1933 Act), *cert. denied*, 454 U.S. 897 (1981). Investments subject to tax shelter registration also include many large real estate limited partnerships that must register under the Investment Company Act of 1940, and investments that must register under any other federal law regulating securities. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 12 (August 13, 1984). Securities offered and sold only to persons residing in one state are exempt from registration with the SEC, but are subject to tax shelter registration if they must register under state "blue sky" laws. 15 U.S.C. § 77c(a)(11) (1982). In 1974, the SEC adopted rule 147 in order to clarify the terms of the intrastate offering exemption. 17 C.F.R. § 230.147 (1984); *see* Cummings, *The Intrastate Exemption and the Shallow Harbor of Rule 147*, 7 Sec. L. Rev. 245 (1975) (explaining exemption from SEC registration for intra-state securities offerings).

55. I.R.C. § 6111(c)(1)(B)(ii) (1984). Investments subject to tax shelter registration include private offerings and "small" dollar offerings that, although exempt from federal securities registration, must file notice with the SEC. 15 U.S.C. §§ 77d(2), 77c(b) (1982). The applicability of the private offering exemption to securities registration depends on whether the particular class of persons need the protection of the Act. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953). In 1982, the SEC enacted Regulation D to provide detailed guidelines for the private offering exemption. 17 C.F.R. §§ 230.501-230.506 (1984). The guidelines vary with the size of the offering and knowledge of the purchasers. *See* Donahue, *New Exemptions From the Registration Requirements of the Securities Act of 1933: Regulation D*, 10 Sec. Reg. L. J. 235 (1982) (outlining use of Regulation D for private offerings); *see also* Warren, *A Review of Regulation D: The Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933*, 33 Am. U.L. Rev. 355 (1984) (same). In general, the "small" dollar securities offering exemption applies to investment offerings of $5,000,000 or less. 15 U.S.C. § 77c(b) (1982). The SEC's enactment of Regulation D in 1982 established specific rules for the "small" dollar offering exemption, such as a prohibition of general solicitation or general advertising of the securities. 17 C.F.R. §§ 230.501-230.506 (1984). In addition to exemptions under Regulation D, Regulation A provides a limited exemption from registration for securities offerings of $1,500,000

classified as a "substantial investment."[56] Section 6111 defines "substantial investments" as those sold to five or more investors for a total of more than 250,000 dollars.[57]

Soon after Congress passed the 1984 Act, the Treasury Department issued temporary and proposed regulations for tax shelter registration.[58] The Treasury Department regulations, issued on August 13, 1984, required registration of various investments not intended as tax shelters, such as law partnerships and family farms.[59] Lawyers, accountants, and many others complained that the tax shelter registration regulations failed to distinguish legitimate businesses providing net income from tax shelters designed to provide tax benefits.[60] In response to the complaints, the Treasury Department amended the temporary and proposed regulations on October 26, 1984.[61] The October 26 amendments distinguish between investments that reduce investors' tax liabilities and investments that generate net income for investors.[62] According to the October 26 amendments, the IRS has suspended tax shelter registration for "projected income investments."[63] A tax shelter organizer need not register a "projected income investment" if the organizer provides investors with a written statement indicating the organizer's intent to generate net income rather than net tax benefits.[64] Should a "projected

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or less. 17 C.F.R. §§ 230.251-230.263 (1984). Investments subject to tax shelter registration also include those sold pursuant to an exemption under a state "blue sky" law that requires notice with a state securities agency. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 12 (August 13, 1984).

56. I.R.C. § 6111(c)(1)(B)(iii) (1984).

57. I.R.C. § 6111(c)(4) (1984). In determining whether a tax shelter meets the substantial investment test, the IRS will aggregate the number of investors and the dollar amounts offered for similar investments organized by the same or related persons. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 13-14 (August 13, 1984). If the investment is a family farm, the IRS will consider individual interests of each member of the immediate family as held by one investor. Treas. Reg. § 301.6111-1T (amended), T.D. 7990, 1984-48 I.R.B. 17, 19 (October 26, 1984).

58. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6 (August 13, 1984).

59. *See* Moore, *IRS Sweeps Law Firms Into Net for Registration of Tax Shelters*, Legal Times, September 3, 1984, at 1 (discussing broad definition for investments that must register as tax shelters under Treasury Department regulations issued August 13, 1984).

60. *Id.*

61. Treas. Reg. § 301.6111-1T (amended), T.D. 7990, 1984-48 I.R.B. 17 (October 26, 1984).

62. *Id.* at 20-21. The October 26 amendments to tax shelter registration rules did not change the definition of a tax shelter. *Id.* Instead, the amendments specify rules for tax shelters that are not expected to reduce the cumulative tax liability of any investor during the first five years of the investment. *Id.*

63. *Id.* According to the October 26 amendments to tax shelter registration regulations, a tax shelter is a "projected income investment" if it is not expected to reduce the tax liability of any investor for any year and the investment does not include any interest in a collectible, sound recording, film, or literary, musical, or artistic composition. *Id.* at 21-22.

64. *Id.* at 21. The October 26 amendments suspending tax shelter registration for certain investments require a written statement that will lead a reasonable investor to believe the investment will not reduce the cumulative tax liability of any investor. *Id.*

income investment" later produce tax benefits for any investor exceeding taxes already paid on investment income, the organizer must register the investment as a tax shelter.[65] In addition to suspending tax shelter registration for "projected income investments," the October 26 amendments provide registration exemptions for the performance of services and for businesses that sell or lease tangible personal property.[66] If the recipient of the services, purchaser, or lessee uses the services or property for personal use or in connection with his principal active business, he is not treated as a tax shelter investor.[67]

The new tax shelter registration form specifically requires the tax shelter organizer to disclose identifying information about the organizer and investment property, the dollar value of the entire investment, and the number of interests the organizer expects to sell.[68] The tax shelter registration form also requires disclosure of expected values of tax benefits and the maximum tax shelter ratio possible for any investor.[69] After the tax shelter organizer submits the registration form, the IRS assigns a registration number to the investment.[70] The organizer must furnish the registration number to investors.[71] Investors then must report the registration number on their tax returns.[72] Consequently, the 1984 Act enables the IRS to match the returns of tax shelter investors with registered tax shelters.[73]

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65. *Id.* at 22-23. If an unregistered "projected income investment" reduces the cumulative tax liability of any investor, the organizer must register the investment with the IRS within 30 days after the end of the year in which the reduction occurred. *Id.* The tax shelter organizer also must furnish the tax shelter registration number to all investors. *Id.* The October 26 amendments fail to provide special rules for subsequent registration when no tax shelter organizer participates in the ongoing management of a "projected income investment" and no one can determine when subsequent registration may be required. *Id.*

66. *Id.* at 20. According to the October 26 amendments, the tax shelter registration exemptions for sales and leases of tangible personal property does not apply if the property is collectibles, master sound recordings, film, or literary, musical, or artistic compositions. *Id.*

67. *Id.* The tax shelter registration exemption for purchasers or lessees of tangible personal property applies to persons such as farmers who purchase cattle feed in the ordinary course of farming, rather than non-farmers who purchase an interest in a cattle-feeding tax shelter. *Id.*

68. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 19-23 (August 13, 1984) (prescribing information that must be included in new form 8264, application for registration of tax shelter).

69. *Id.* at 22-32.

70. I.R.C. § 6111(b)(1) (1984). Assignment of a tax shelter registration number does not indicate that the IRS has reviewed or approved the tax shelter or claimed tax benefits. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36, I.R.B. 6, 18 (August 13, 1984).

71. I.R.C. § 6111(b)(1) (1984). When a tax shelter organizer informs investors that an investment has been registered, the organizer also must provide a disclaimer stating that issuance of a registration number does not indicate IRS review or approval. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 17 (August 13, 1984).

72. I.R.C. § 6111(b)(2) (1984). Any person claiming tax benefits from a registered tax shelter must report the registration number, regardless of the amount of tax benefits or the tax shelter ratio for that particular person. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 18-19 (August 13, 1984).

73. *See A Tax Shelter Rule That Could Snuff Out Big Write-Offs*, Businessweek, September 10, 1984, at 119 (suggesting that investors' entry of registration number on their tax

In addition to tax shelter registration, the 1984 Act requires organizers and sellers of "potentially abusive" tax shelters to keep lists of investors.[74] Before the 1984 Act, some tax shelter organizers and sellers did not keep investor lists.[75] Even if organizers and sellers did keep investor lists, the IRS had to rely on its summons authority to obtain the lists.[76] Under the 1984 Act, organizers and sellers of "potentially abusive" tax shelters must supply investor lists to the IRS on request.[77] The 1984 Act defines "potentially abusive tax shelters" as those that organizers must register with the IRS under section 6111, and any other investments specified in future regulations that show "a potential for tax avoidance or evasion."[78] Congress created the investor list requirement to help the IRS quickly identify all investors in an abusive tax shelter and ensure that all investors receive uniform treatment.[79]

The 1984 Act imposes substantial penalties for failure to comply with tax shelter registration and investor list requirements. If an organizer or seller of a "potentially abusive" tax shelter fails to maintain an investor list, the IRS may assess a fifty dollar penalty for each investor omitted from the

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return is the major impact of tax shelter registration under the 1984 Act); *see also* H. R. REP. No. 861, 98th Cong., 2d Sess. 977, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 751, 971. The 1984 Conference Committee suggested that lack of tax shelter registration results in lack of complete and systematic information on which the IRS can base audit decisions. *Id.*

74. I.R.C. § 6112 (1984) (added by Tax Reform Act of 1984, § 142). *See* Treas. Reg. § 301.6112-1T, T.D. 7969, 1984-41 I.R.B. 27 (August 24, 1984). "Potentially abusive" tax shelter investor lists must include the name, address, and taxpayer identification number of each investor, the number of units acquired by each investor, and the date on which each interest was acquired. *Id.* at 31. If the investor did not acquire the interest from the person maintaining the list, the investor list must include the name of the person from whom the interest was acquired. *Id.* Finally, the list must include the name and address of each agent of the person maintaining the list. *Id.* A separate list must be maintained for each tax shelter, and each list must be retained for seven years. *Id.* at 31-32.

75. H. R. REP. No. 432, 98th Cong., 2d Sess. 1351, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 3, 310.

76. *See* I.R.C. § 7602 (1984) (IRS authority to summon tax records); I.R.C. § 7603 (1984) (amended by Tax Reform Act of 1984, § 911) (procedure for service of IRS summons).

77. I.R.C. § 6112(c)(1)(A) (1984).

78. I.R.C. § 6112(b)(1)-(b)(2) (1984). In amendments to the tax shelter registration regulations, issued on October 26, 1984, the Treasury Department suspended registration for investments intended to generate a profit, but retained the investor list requirement for such investments. Treas. Reg. 301.6111-1T (amended), T.D. 7990, 1984-48 I.R.B. 17, 18 (October 26, 1984).

79. H. R. REP. No. 432, 98th Cong., 2d Sess. 1351, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 3, 310 (explaining purpose of investor list requirement to help IRS locate tax shelter investors after IRS has determined that tax shelter is abusive). In addition to the new investor list requirement under the 1984 Act, Congress in 1982 authorized the IRS to determine each tax shelter investor's tax liability at the partnership level rather than in separate proceedings for each partner. I.R.C. §§ 6221-6231 (1984) (providing rules for treatment of partnership items in single proceeding); *see* Boles, *All Partnerships Subject to More Effective Audits as a Result of Changes Made By TEFRA*, 11 TAX'N LAW. 354, 358 (1983) (explaining partnership audit rules).

list, with a maximum penalty of 50,000 dollars in one year.[80] If a tax shelter organizer fails to register or provides incorrect tax shelter registration information, the IRS may charge a penalty of five hundred dollars or one percent of the total amount invested in the tax shelter, whichever is greater, with a maximum penalty of 10,000 dollars.[81] If a tax shelter organizer intentionally fails to register, the 10,000 dollar limit does not apply and the IRS may seek criminal penalties.[82] Under the 1984 Act, the IRS also may penalize an attorney who wrote a tax shelter opinion for an unregistered tax shelter if the attorney participated in the "entrepreneurial risks and benefits" of the tax shelter.[83] "Entrepreneurial risks and benefits" include receipt of an interest in the tax shelter or compensation based on sale of tax shelter interests.[84] Tax shelter investors who omit the registration number from their tax returns are subject to a fifty dollar penalty for each omission.[85]

The 1984 Act also increases the penalty against promoters of abusive tax shelters.[86] Before the 1984 Act, section 6700 authorized the IRS to assess

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80. I.R.C. § 6708 (1984) (added by Tax Reform Act of 1984, § 142). Under the 1984 Act, the IRS will charge a penalty for failure to maintain a list of tax shelter investors unless the failure is due to reasonable cause. *Id.*

81. I.R.C. § 6707 (1984) (added by Tax Reform Act of 1984, § 141). According to new § 6707, the IRS will not penalize tax shelter organizers if failure to register a qualifying tax shelter was due to reasonable cause. *Id.* Under Treasury Department regulations issued October 26, 1984, tax shelter organizers must register by November 5, 1984, for qualifying tax shelter interests sold after August 31, 1984. Treas. Reg. § 301.6111-1T (amended), T.D. 7990, 1984-48 I.R.B. 617 (October 26, 1984).

82. I.R.C. § 6707(a)(2) (1984). A tax shelter organizer's willful noncompliance with registration rules could result in a misdemeanor charge for failure to file a return or supply information to the IRS, or a felony charge for providing fraudulent or false statements. Treas. Reg. § 301.6707-1T, T.D. 7964, 1984-36 I.R.B. 6, 23-24 (August 13, 1984); *see supra* notes 53-54 and accompanying text (explaining securities registration rules); *cf.* 15 U.S.C. § 77x (1982) (providing criminal penalties against sellers of securities for willful violation of securities registration laws); Russo, *Rule 10b-5 Litigation and Tax Shelter Investments*, 10 SEC. REG. L.J. 339 (1983) (examining civil liabilities of tax shelter organizers and tax attorneys who fraudulently disclose information in securities registration statements).

83. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 14-16 (August 13, 1984). If the principal organizer of a tax shelter has not registered the tax shelter with the IRS, any person who participated in the organization must register the tax shelter if he also participated in the shelter's "entrepreneurial risks and benefits." *Id.* at 15. If neither a person principally responsible for organizing the tax shelter nor any other person who participated in the organization has registered the tax shelter, any person who participated in the management of the tax shelter must register. *Id.* Finally, if a person participating in the sale of a tax shelter knows or has reason to know that the tax shelter was not registered, the IRS will treat that person as a tax shelter organizer. *Id.*; *see supra* notes 33-39 and accompanying text (explaining rules under Circular 230 for attorneys who write tax shelter opinions).

84. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 15 (August 13, 1984).

85. I.R.C. § 6707(b)(2) (1984). The IRS will penalize tax shelter investors for failure to include the tax shelter registration number on their returns unless the failure is due to reasonable cause. *Id.* The IRS also will assess a $100 penalty against tax shelter organizers for each failure to furnish the tax shelter registration number to an investor. I.R.C. § 6707(b)(1) (1984).

86. I.R.C. § 6700 (1984) (amended by Tax Reform Act of 1984, § 143); *see* Khoury, *TEFRA's Compliance Provisions: Impact on Tax Shelter Investments*, 7 REV. TAX'N INDIVIDUALS

fines of 1,000 dollars or ten percent of the promoter's net income from sale of abusive tax shelter interests, whichever was greater.[87] The IRS assessed the section 6700 penalty when a tax shelter promoter fradulently misrepresented tax benefits or overstated the value of tax shelter property by more than two hundred percent.[88] In 1984, Congress concluded that the existing penalty did not effectively deter abusive tax shelter promoters because the penalty was too small in relation to the promoter's income from sale of tax shelter interests.[89] To enhance the deterrent effect, the 1984 Act increased the section 6700 penalty to 1,000 dollars or twenty percent of the tax shelter promoter's income, whichever is greater.[90]

In addition to the section 6700 penalty against promoters of abusive tax shelters, the IRS may seek injunctions under section 7408 to prevent promotion and sale of tax shelter interests.[91] When the IRS seeks an injunction, the IRS first must show a tax shelter promoter's conduct is subject to penalty under section 6700.[92] The IRS also must show that enjoining the promoter

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195 (1983) (explaining abusive tax shelter promoter penalty). In addition to the abusive tax shelter promoter penalty, promoters of abusive tax shelters may be subject to criminal sanctions. *See* Maguire, *Scamalot: The Land of Tax Shelter Prosecutions*, 70 A.B.A. J. 52 (1984) (reporting criminal prosecutions of tax shelter promoters for tax fraud). In 1983, the IRS recommended 108 abusive tax shelter promoter cases for criminal prosecution. *See* Pike, *New Salvos In the Tax Shelter War*, NAT'L LAW. J., March 12, 1984, at 38, Col. 3. The courts indicted 44 tax shelter promoters and convicted 34 during 1983. *Id.*; *see, e.g.*, U.S. v. Flomenhoft, 714 F.2d 708 (7th Cir. 1983) (convicting tax attorney who promoted faudulent tax shelter), *cert. denied*, 104 S. Ct. 1420 (1984). The government may base criminal tax fraud charges on a variety of tax shelter misconduct such as fraudulent overvaluation, fictitious financing expenses, backdated documents, sham transactions, false books, or obstruction of an IRS audit. *See* I.R.C. § 7206 (1984) (felony penalty for fraud and false statements); I.R.C. § 7207 (1984) (amended by Tax Reform Act of 1984, § 491) (misdemeanor penalty for fraudulent statements).

87. I.R.C. § 6700(a) (1982), *amended by* Tax Reform Act of 1984, § 143.

88. I.R.C. §§ 6700(a)(2)(A)-6700(b) (1984). Under § 6700, enacted in 1982, a tax shelter promoter is defined as an organizer or seller of a tax shelter. I.R.C. § 6700(a) (1982). Although § 6700 does not specifically define an abusive tax shelter, a tax shelter promoter is liable if he makes or furnishes a statement which he knows or has reason to know is false or fraudulent, or if he makes a valuation overstatement exceeding 200% of the correct value of tax shelter property. I.R.C. § 6700(a)(2)(A)-(a)(2)(B) (1984).

89. *See* H. R. REP. No. 432, 98th Cong., 2d Sess. 1357, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 3, 315 (concluding that existing abusive tax shelter promoter penalty was too low because promoters operate on large margin and receive large percentage of tax deductions provided for investors).

90. I.R.C. § 6700(a) (1984).

91. I.R.C. § 7408 (1984) (amended by Tax Reform Act of 1984, § 143); *see* Slaughter, *The Empire Strikes Back: Injunctions of Abusive Tax Shelters After TEFRA*, 3 VA. TAX. REV. 1 (1983) (explaining penalties and injunctions against abusive tax shelter promoters). After the IRS identifies an abusive tax shelter promotion and petitions the court for an injunction, the IRS may send letters to investors indicating that tax savings from the tax shelter are not allowable. *See supra* note 29 and accompanying text (explaining procedure for letters to investors in abusive tax shelters).

92. I.R.C. § 7408(b)(1) (1984).

is "appropriate to prevent recurrence of such conduct."[93] In setting forth the 1984 Act, Congress concluded that additional abusive tax shelter activities proscribed by section 6701 should be subject to injunction.[94] Section 6701 specifies penalties against persons who aid and abet tax shelter abuse, including persons who furnish gross valuation overstatements for tax shelter property.[95] The 1984 Act amends section 7408 to authorize injunctions against nonpromoters who are subject to the penalties of section 6701.[96]

The 1984 Act also amends interest penalties against taxpayers who invest in abusive tax shelters. Before the 1984 Act, the IRS charged the prime rate of interest,[97] beginning from the date of notice and demand, against tax underpayments.[98] Congress recognized, however, that taxpayers who delayed resolution of their cases profited from use of the money during the delay.[99] Congress also expressed concern about the rising backlog of tax shelter cases under IRS examination and in the Tax Court.[100] To encourage prompt resolution of cases, the 1984 Act increased the interest rate to one hundred and twenty percent of the prime rate if a tax underpayment of 1,000 dollars or more is attributable to "tax-motivated transactions."[101] Under the 1984 Act, "tax-motivated transactions" include use of property overvaluations,[102] disallowed investment tax credits,[103] tax straddles,[104] and accounting methods

93. I.R.C. § 7408(b)(2) (1984); *see* United States v. Buttorff, 563 F. Supp. 450, 454-55 (N.D. Tex. 1983) (injunction was appropriate remedy because of tax shelter promoter's history of abusive tax activities and likelihood of continued abusive tax shelter activities).

94. *See* H. R. Rep. No. 861, 98th Cong., 2d Sess. 983, *reprinted in* 1984 U.S. Code Cong. & Ad. News No. 6B, at 751, 977 (concluding that injunctions of abusive tax shelter-related activity should not be limited to injunctions against promoters of abusive tax shelters under § 6700).

95. I.R.C. § 6701 (1984).

96. I.R.C. § 7408 (1984).

97. I.R.C. § 6621 (1984) (amended by Tax Reform Act of 1984, § 144) (determination of rate of interest for tax underpayments).

98. I.R.C. § 6601 (1984) (amended by Tax Reform Act of 1984, § 158) (interest penalty against taxpayers who fail to file returns or understate tax liability).

99. *See* S. Rep. No. 169, 98th Cong., 2d Sess. 451 (1984) (expressing concern that strength of penalties against investors in abusive tax shelters should not be diluted by delays, particularly when investor seeks to avoid resolution of his case).

100. *See id.* at 436. The 1984 Senate Finance Committee traced the increase of tax shelter cases under examination by the IRS from 195,000 at the end of 1980 to 285,000 at the end of 1982. *Id.* The Committee also was alarmed that the backlog of pending cases in the Tax Court had increased from 34,776 to 53,440 over the same period. *Id.*; *see supra* note 24 (discussing increase from 1982 through 1984 of tax shelter investor returns under IRS examination and cases pending in the Tax Court).

101. I.R.C. § 6621(d) (1984) (amended by Tax Reform Act of 1984, § 144).

102. *See* I.R.C. § 6659(c) (1984) (providing specifications for valuation overstatements that are classified as "tax-motivated transactions" under 1984 Act).

103. *See* I.R.C. § 46(c)(8) (1984) (providing rule for disallowed investment tax credits claimed on investor's return). In addition to disallowed investment tax credits, the 1984 Act classified any loss disallowed under the "at risk" rules as a "tax-motivated transaction." *See* I.R.C. § 465(a) (1984) (prohibiting taxpayers from claiming tax deductions for losses in excess of the amount "at risk," the amount the taxpayer could lose if the investment failed).

104. *See* I.R.C. § 1092(c) (1984). In general, a straddle consists of the simultaneous holding

that potentially distort income.[105] The 1984 Act also extends the time period for interest penalties to begin on the due date of the return instead of waiting until the date of notice and demand.[106]

In addition to interest penalties, investors in abusive tax shelters may face the substantial understatement penalty under section 6661[107] and the property overvaluation penalty under section 6659.[108] The IRS may assess the substantial understatement penalty when a taxpayer's return understates his tax liability by at least ten percent or 5,000 dollars, whichever is greater.[109] The penalty is equal to ten percent of the substantial understatement.[110] To avoid the substantial understatement penalty, a tax shelter investor must show that he relied on "substantial authority" for his tax treatment and that he reasonably believed it was more likely than not the correct tax treatment.[111] Substantial authority may include the Internal Revenue Code, Treasury Department regulations, revenue procedures, and Tax Court decisions, but not the legal opinions of tax professionals.[112]

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of both long and short positions in commodities future contracts. *See* Turlington, *The Long And the Short of Straddles As A Tax Saving Device: An Historical Update of Revenue Ruling 77-185*, 40 N.Y.U. INST. FED. TAX'N § 16 (1982) (defining tax straddles). Investors have used straddles to defer current tax liability until a later year when they recognize a loss from one position before a gain from the opposite position of the straddle. *Id.*

105. *See* H. R. REP. No. 861, 98th Cong., 2d Sess. 984-85, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS No. 6B, at 751, 978-79 (listing seven examples of accounting methods which may result in substantial distortion of income, subject to increased interest penalty under 1984 Act if taxpayer underpays tax liability).

106. I.R.C. § 6601(e)(2) (1984) (amended by Tax Reform Act of 1984, § 158).

107. I.R.C. § 6661 (1984) (amended by Tax Reform Act of 1984, § 714); *see* Seigel, *New Penalty Provisions-Some Practical Considerations*, 61 TAXES 788 (1983) (explaining substantial understatement penalties against taxpayers). In addition to the imposition of civil penalties against abusive tax shelter investors, the IRS has threatened abusive tax shelter investors with criminal prosecution if the investor is culpable of tax abuse or knew that his investment abused the tax system. Moore, *Investors Targeted By IRS Officials in Tax Shelter Push*, Legal Times, Jan. 30, 1984, at 1.

108. I.R.C. § 6659 (1984) (amended by Tax Reform Act of 1984, § 155); *see* Seigel, *New Penalty Provisions—Some Practical Considerations*, 61 TAXES 788 (1983) (examining penalty against taxpayers who underpay taxes because of property overvaluation).

109. I.R.C. § 6661(b)(1)(A) (1984).

110. I.R.C. § 6661(a) (1984).

111. I.R.C. § 6661(b)(2) (1984). The IRS will reduce the penalty against a tax shelter investor for substantial understatement of his taxes by that portion of the understatement which is due to reliance on "substantial authority" if the investor also reasonably believed that the tax treatment was more likely than not the proper treatment. Treas. Reg. § 1.6661, 1983-1 C.B. 1057, 1061 (1983). The IRS will consider that a tax shelter investor "reasonably believed" that the tax treatment was more likely than not proper if the taxpayer examined the facts or opinion of a professional tax adviser, predicting a greater than 50% likelihood that a court would uphold the tax treatment. *Id.* at 1062; *see supra* notes 33-39 and accompanying text (explaining rules for tax shelter opinions). Unlike tax shelter investors, other taxpayers who substantially understate tax liability may reduce the IRS penalty if the taxpayers show they relied on substantial authority or if the taxpayers disclose all relevant facts affecting tax treatment on their return. I.R.C. § 6661(b)(2)(B) (1984).

112. Treas. Reg. § 1.6661, 1983-1 C.B. 1057, 1060-61 (1983).

The IRS may assess the property overvaluation penalty when a tax underpayment resulted from property value overstated in excess of one hundred and fifty percent of the correct amount.[113] The overvaluation penalty is not limited to abusive tax shelters, but may be imposed for any questionable valuation of any type of property.[114] If the taxpayer overvalues property by more than one hundred and fifty percent but not more than two hundred percent, the penalty is ten percent of the resulting tax underpayment.[115] For overvaluations of more than two hundred percent but not more than two hundred and fifty percent, the penalty is twenty percent of the tax underpayment.[116] If the overvaluation exceeds two hundred and fifty percent, the penalty is thirty percent of the tax underpayment.[117] In promulgating the 1984 Act, Congress was particularly concerned about overvaluation of charitable contributions used for tax deductions.[118] To deter taxpayers from claiming inflated tax deductions for charitable contributions, the 1984 Act raised the penalty for overvaluation of charitable contributions to a flat thirty percent of the underpayment.[119] The 1984 Act also imposes strict standards on appraisal of property for charitable contributions.[120]

The 1984 Act could significantly increase the risk of audit for investors in abusive tax shelters.[121] Investors may expect that the IRS is more likely to audit registered tax shelters having high tax shelter ratios.[122] If an IRS audit reveals tax abuse, investors face increasingly stiff penalties.[123] To minimize

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113. I.R.C. § 6659(c) (1984).

114. *See* H. R. Rep. No. 215, 97th Cong., 1st Sess. 262, *reprinted in* 1981 U.S. Code Cong. & Ad. News 285, 351 (explaining that IRS overvaluation penalty against taxpayers applies to overvaluation of any property).

115. I.R.C. § 6659(b) (1984).

116. *Id.*

117. *Id.*

118. *See* S. Rep. No. 169, 98th Cong., 2d Sess. 443-44 (1984). The 1984 Senate Finance Committee was concerned about situations in which taxpayers or tax shelter promoters acquire assets, hold the property for at least the capital gains holding period, and then contribute the assets to a museum, library, or educational institution at their appreciated value far in excess of their actual value. *Id.*

119. I.R.C. § 6659(f) (1984).

120. *See* I.R.C. § 170 (1984) (authorizing Treasury Department regulations to determine allowance of charitable contributions). The 1984 Act requires qualified appraisals before a taxpayer may claim a charitable contribution for property with value exceeding $5,000. *Id.* A qualified appraisal includes a description of the property and the qualifications of a qualified appraiser. *Id.* The taxpayer must attach the appraisal summary to his tax return. *Id.*

121. *See* S. Rep. No. 169, 98th Cong., 2d Sess. 426 (1984) (explaining that tax shelter registration and investor list rules will enable IRS to identify tax shelters and audit all investors after the IRS detects abusive tax shelter). *But see* Roscoe L. Egger, IRS Commissioner, Remarks at the August 13, 1984 News Conference Announcing Tax Shelter Registration Regulations, *reported in* Daily Tax Report (BNA) 157, at G-3 (August 14, 1984) (claiming that a taxpayer's chance of being audited by IRS will not increase as result of tax shelter registration).

122. *See A Shelter Rule That Could Snuff Out Big Write-Offs*, Businessweek, September 10, 1984, at 119 (suggesting that there are far too may tax shelters with ratios below 3 to 1 for the IRS to screen each one closely).

123. *See* Moore, *Investors Targeted By IRS Officials in Tax Shelter Push*, Legal Times,

the risk of audit, some taxpayers may prefer to invest in tax shelters that do not qualify for registration with the IRS.[124] Other investors, however, may prefer registered tax shelters because they incorrectly believe that registration confers legitimacy.[125] Cautious investors may prefer new tax shelters that provide insurance against risk of failure to realize economic or tax benefits, and tax shelters that include money-back guarantees.[126] Even if tax shelters provide no insurance or guarantee, investors may recover their economic losses from tax shelter organizers who misrepresented economic or tax benefits of the investment.[127]

The tax shelter registration rules of the 1984 Act will enhance IRS ability to quickly identify cases for penalties and injunctions against abusive tax shelter promoters.[128] Tax shelter promoters, however, expect that broad registration rules may limit the ability of the IRS to examine effectively the large numbers of tax shelters that organizers undoubtedly will register.[129] As a result of the 1984 Act, the IRS may shift efforts from investigation of tax shelters in the marketplace to investigation of registration forms in the office.[130] Tax shelter organizers may design new tax shelters with low tax

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Jan. 30, 1984, at 1 (discussing criminal prosecution of tax shelter investors); *see also supra* notes 97-120 and accompanying text (explaining penalties against investors in abusive tax shelters).

124. *See A Shelter Rule That Could Snuff Out Big Write-Offs*, Businessweek, September 10, 1984, at 119 (suggesting that there are far too many tax shelters with ratios below 3 to 1 for the IRS to screen each one closely). Investments having tax shelter ratios below 2 to 1, under five investors, or total investments below $250,000 do not qualify for registration. I.R.C. § 6111(c) (1984); *see supra* notes 56-57 and accompanying text (explaining tax shelter registration qualifications for "substantial investments").

125. *See A Shelter Rule That Could Snuff Out Big Write-Offs*, Businessweek, September 10, 1984, at 119 (suggesting that some investors will gain false confidence from knowledge that tax shelters are registered with the IRS, because tax shelters with ratios exceeding 2 to 1 are commonplace). When a tax shelter organizer informs investors that an investment has been registered, the organizer also must provide a disclaimer stating that issuance of a registration number does not indicate IRS review or approval. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 17 (August 13, 1984).

126. *See The Hard Sell Is On To Push A New Crop of Shelters*, Businessweek, July 9, 1984, at 88 (explaining how tax shelter promoters have designed innovative investments and applied fresh marketing ideas to counteract adverse publicity about tax shelters).

127. *See* Salcer v. Envicon Equities, 744 F.2d 935, 939-44 (2d. Cir. 1984) (awarding damages for economic loss, less tax benefits received by investors, against tax shelter organizers who misrepresented property to investors). *But see* Burgess v. Premier Corp., 727 F.2d 826, 837-38 (9th Cir. 1984) (declining to deduct tax benefits from recissionary damage award because tax benefits due to tax shelter abuse).

128. *See* Roscoe L. Egger, IRS Commissioner, Remarks at the August 13, 1984 News Conference Announcing Tax Shelter Registration Regulations, *reported in* Daily Tax Report (BNA) 157, at G-3 (August 14, 1984) (stating that tax shelter registration rules will enhance IRS ability to identify abusive cases which warrant injunction).

129. *See id.* (explaining that tax shelter registration rules cover "perfectly acceptable" tax shelters as well as "abusive" tax shelters, so that IRS can determine total tax shelters in use).

130. *See* Tax Notes, August 29, 1983, at 763 (reporting that 8.9% of IRS direct examination time in first half of 1983 involved abusive tax shelters).

shelter ratios because they expect the IRS will first examine tax shelters with high tax shelter ratios.[131]

Tax shelter organizers may have difficulty determining whether or not their particular tax shelter qualifies for registration with the IRS. According to the 1984 Act, organizers must register investments if persons may "reasonably infer" that the tax shelter ratio exceeds two to one.[132] Some investments may have different tax shelter ratios for each investor after each of the first five years of the investment.[133] Moreover, some tax benefits involve complex calculations and uncertain IRC interpretations. Investment organizers, investors, and the IRS might draw reasonable but different inferences about represented tax benefits. Investment organizers facing potential penalties may prefer a more definite standard to qualify investments for registration.

In addition to the tax shelter organizer penalties, the 1984 Act and Circular 230's new standards for tax shelter opinions provide stiff liabilities for tax attorneys. The 1984 Act may discourage attorneys and accountants from taking aggressive positions in tax shelter opinions.[134] Tax professionals expect that the 1984 Act and the new Treasury Department standards will increase IRS policing of tax shelter opinions.[135] In addition, tax attorneys may be defendants in tax fraud actions brought by investors in abusive tax shelters.[136]

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131. *See A Tax Shelter Rule That Could Snuff Out Big Write-Offs*, Businessweek, September 10, 1984, at 119 (suggesting that organizers will design tax shelters having tax shelter ratio close to 2 to 1 or slightly below 2 to 1).

132. I.R.C. § 6111(c)(1)(A) (1984); *see supra* notes 49-52 and accompanying text (explaining standard for determining if tax shelter ratio exceeds 2 to 1); *see also* Treas. Reg. 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 10 (August 13, 1984). According to Treasury regulations for tax shelter registration, a "reasonable inference" of tax benefits includes tax benefits that the organizer explicitly represents as well as other tax benefits typically associated with the investment. *Id.* The organizer should estimate tax deductions and tax credits if he cannot determine specific amounts. *Id.*

133. Treas. Reg. § 301.6111-1T, T.D. 7964, 1984-36 I.R.B. 6, 12 (August 13, 1984).

134. *See* Garbis, *The Tax Professional and the New Tax Compliance Environment*, 29 WM. & MARY TAX. CONF. 9, 23 (1984) (suggesting that increased penalty exposure for tax attorneys who prepare tax shelter opinions will discourage aggressive planning and reporting).

135. *See* Schlenger & Watkins, *Exploring the Myths of Circular 230*, 62 TAXES 283, 289-90 (1984) (questioning wisdom of governmental intervention between tax attorneys and taxpayers); *see also supra* notes 30-39 and accompanying text (outlining standards for attorneys who prepare tax shelter opinions).

136. *See, e.g.*, Hudson v. Capital Management International, Inc. 565 F. Supp. 615, 622 (N.D. Cal. 1983) (dismissing securities fraud claim against tax attorney because investor failed to allege transactional nexus of tax shelter opinion); Morgan v. Prudential Group, Inc., 527 F. Supp. 957, 959-60 (S.D.N.Y. 1981) (finding no liability to investor on basis of fraud because attorney was unaware of defect in his tax shelter opinion), *aff'd*, 729 F.2d 1443 (1984). If an attorney participates in a fraudulent tax shelter promotion, he may be subject to criminal sanctions. *See* U.S. v. Flomenhoft, 714 F.2d 708 (7th Cir. 1983) (convicting tax attorney who promoted fraudulent tax shelter), *cert. denied*, 104 S. Ct. 1420 (1984). *See generally* Moore, *Shelter Investors Stung by IRS Wreak Vengeance on Lawyers*, Legal Times, June 25, 1984, at 1 (reporting several tax shelter investor suits against attorneys who failed to alert investors

The 1984 Act is the latest in a fifteen-year series of tax reforms that attack abusive tax shelters.[137] Tax shelter registration under the 1984 Act will enhance significantly the ability of the IRS to detect abusive tax shelters.[138] Consequently, some tax shelter promoters and investors will move to safer investments that have less likelihood of tax abuse.[139] Congressional and Treasury Department proposals for tax simplification[140] could drastically reduce the number of tax benefits available to investors. If Congress further eliminates tax benefits, however, the tax law will legislate many tax shelters and investment incentives out of existence.[141] The 1984 Act does not legislate tax shelters out of existence, but attacks abusive tax shelters with administrative rules and penalties. The registration and investor list rules of the 1984 Act, while attacking promoters and investors in abusive tax shelters, also burden those involved in non-abusive tax shelters. The blunt-edged rules of the 1984 Act may be the last defense against abusive tax shelters before wholesale tax reform.

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about potential tax shelter problems); Pike, *Shelters: A Legal Minefield*, NAT'L LAW J., March 19, 1984, at 1 (describing potential liabilities of lawyers who write tax shelter opinions).

137. *See supra* notes 17-23 and accompanying text (reviewing tax reform legislation from 1969 through 1983 directed at abusive tax shelters).

138. *See* S. REP. No. 169, 98th Cong., 2d Sess. 426 (1984) (explaining that tax shelter registration will provide the IRS with basic information when tax shelters are first offered for sale).

139. *See A Tax Shelter Rule That Could Snuff Out Big Write-Offs*, Businessweek, September 10, 1984, at 119 (suggesting that tax shelters with established tax benefits, such as real estate, may be safer than more exotic tax shelters, such as art or phonograph records).

140. *See Tax Reform For Fairness, Simplicity, and Economic Growth—The Treasury Department Report to the President*, Tax Notes, December 3, 1984, at 873 (outlining Treasury Department's 1984 tax reform proposal); *see also* Burton, *Major Tax Reform Proposals At A Glance*, Tax Notes, June 4, 1984, at 1095. Congressional tax reform proposals include the "Fair and Simple Tax" (S. 2600, H.R. 5533), the "Fair Tax Act" (S. 1421, H.R. 3271), the "Flat Tax" (S. 557), the "Simple, Efficient, Low and Fair Tax Plan" (S. 1040) and the consumption or cash-flow tax (H.R. 4442). *Id.*

141. *See* Beaudry, *The Flat Rate Tax: Is it a Viable Solution to the Crisis Facing the Internal Revenue Code?*, 9 OKL. CITY U. L. R. 219 (1984) (explaining benefits and problems of tax reform); *see also* Oddo, *Flat Tax, Fair Tax: New Hope For Reforming the Internal Revenue Code*, 11 J. LEGIS. 521 (1984) (evaluating various tax reform proposals).