Abstract - Tax shelters in the late 1990s gave rise to large tax savings for taxpayers, considerable fees for professionals, and large revenue losses for the government. Discouraging participation in tax shelters requires decreasing the profitability of such participation. This article describes how recent measures deter tax shelters by either decreasing the expected benefits or increasing the expected costs of tax shelters to the various participants. The article also suggests additional measures to further deter tax shelters.

INTRODUCTION

Taxpayers and professionals alike found tax shelters profitable in the late 1990s. Taxpayers garnered large tax savings, and professionals earned sizable fees from related services, with little offsetting downside. Over the last several years, Congress, Treasury and the IRS adopted a series of measures to attack tax shelters. This article describes how, economically, these measures discourage participation in tax shelters. This article also identifies gaps that remain.

WHAT IS THE PROBLEM OF TAX SHELTERS?

Taxpayers may structure their transactions to minimize their taxes. As Justice Learned Hand has stated, “Any one may so arrange his affairs that his taxes shall be as low as possible.”¹ Moreover, in part because of their role as a tool to promote the government’s economic and social goals, the tax laws are complex and interpretive issues abound. As a result, taxpayers have many opportunities to structure their transactions to save taxes. At some point, however, creative tax planning crosses the line and becomes abusive.

In the late 1990s, tax shelters proliferated, generating tens of billions of dollars of tax savings to taxpayers, and losses to the government.² According to Yale Law Professor Michael Graetz, a tax shelter is a “deal done by very smart people that, absent tax considerations, would be very stupid.”³ The General Accounting Office has described a tax shelter as a

¹ Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).
“very complicated transaction[] promoted to corporations and wealthy individuals to exploit tax loopholes and provide large and unintended benefits.” Likewise, the Senate’s Permanent Subcommittee on Investigations (the “Senate Subcommittee”), which, last year, conducted a thorough investigation into tax shelters, defined a tax shelter as a “transaction[n] in which a significant purpose is the avoidance . . . of tax in a manner not intended by the law.”

This article also defines a tax shelter to be the use of the Internal Revenue Code to generate tax benefits that Congress never intended. Ideally, a taxpayer ought to be prevented from stretching the tax laws beyond their intended purpose. Otherwise, the economic and social goals of our tax laws are undercut. This article describes the recent legislative and administrative effort to discourage taxpayers and others from participating in transactions that defeat the intent of the tax laws.

WHO ARE THE PLAYERS?

The tax shelters of the late 1990s included many participants. In general, these participants can be identified as promoters, taxpayers, facilitators, accommodation parties, advisors and auditors. Their involvement in tax shelters was as follows:

- Promoters created tax shelters, and marketed the shelters to taxpayers.
- Taxpayers, particularly corporate taxpayers experiencing stock market pressure to inflate earnings, entered into the transactions in order to reduce their tax liability (e.g., to generate tax losses to offset taxable income).
- Facilitators helped effect the transaction. For example, a broker might buy or sell stock for the taxpayer, or a bank might act as counter-party in a derivative transaction with a taxpayer.
- Accommodation parties, including tax-exempt entities (such as charities or foreign persons), often were allocated taxable income (or relieved of deductions) without suffering any tax liability.
- Advisors evaluated the merits of the transaction or wrote taxpayers opinions on whether the transactions and their tax benefits likely would be sustained.
- Auditors were responsible for overseeing taxpayers’ financial statements (for publicly traded companies) and setting reserves for tax liabilities.

Parties often performed more than one role. For example, some investment banks acted both as promoters and facilitators, devising and marketing the transaction and also providing related financial services. Meanwhile, some auditors also acted as promoters or advisors, marketing tax shelters to, or writing tax opinions for, their audit clients.

WHAT FACTORS CONTRIBUTED TO THE TAX SHELTER PROBLEM?

Many factors contributed to the tax shelter problem in the late 1990s. Complicated technical tax provisions gave rise to loopholes and the potential for big tax savings for taxpayers. These tax complexities may have been unavoidable for an economy as large and as complex as ours. However, exploitation of this complexity turned out
to be profitable for the participants in the tax shelter industry. The profitability of tax shelters, ultimately, was the impetus for this exploitive activity.

For taxpayers, large possible tax savings, combined with a high likelihood of keeping the savings, resulted in significant expected tax benefits from tax shelters. Taxpayers often could use financial derivatives with large notional amounts to generate sizable transactions (and considerable tax benefits). In addition, many objectionable transactions were too complicated for the IRS to decipher on a limited budget. A low risk of detection translated into a high chance that taxpayers could keep the tax benefits.

Meanwhile, the expected costs to taxpayers to engage in tax shelters were dwarfed by the expected tax savings. Up-front costs comprised only the fees due to facilitators, advisors and promoters. Often, the fees were set as a percentage of the anticipated tax benefits, or were contingent upon the tax benefits being sustained (which placed the taxpayer in a “no-lose” situation). The expected back-end costs were small, as the risk of penalties, as with the risk of disallowance of benefits, was remote. Taxpayers could reduce these risks further by paying advisors for opinions that the tax benefits likely would be sustained, which was a defense to penalty imposition.

For promoters and advisors, providing tax shelter services garnered sizable fees and entailed little downside. Promoters devised tax strategies and distributed those strategies broadly. Advisors could sell the same cookie-cutter opinions to multiple taxpayers. Auditors exploited the chance to earn big fees from acting as promoters and advisors and marketed tax shelters to their audit clients. Conflicts of interest abounded as promoters, advisors and auditors collaborated in the mass marketing of tax shelters.6

Changing the benefit-cost analysis for the participants in the tax shelter industry is the natural approach to address the tax shelter problem. Focusing precisely on the incentives of the participants in the tax shelter industry provides a wide range of options to discourage tax shelters. In recent years, measures directed at the participants in the tax shelter industry have multiplied.

WHAT MEASURES HAVE BEEN TAKEN TO ADDRESS THE PROBLEMS?

Discouraging taxpayers and professionals from participating in tax shelters requires either decreasing the expected benefits or increasing the expected costs of such participation. To that end, Congress and the IRS have pursued several new measures in the last few years to decrease the expected benefits, primarily by decreasing the probability that the tax benefits from tax shelters will be permitted. Other measures increase the expected costs to taxpayers and professionals to participate in tax shelters, e.g., by increasing the size of the costs or increasing the likelihood that the costs will be incurred.

Most of the new measures target taxpayers’ incentives. Enacting measures to target taxpayers’ incentives provides a “double-whammy” in the broader goal of discouraging tax shelters. While these measures directly discourage taxpayers from pursuing tax shelters, these measures also reduce the demand for the services of professionals who might participate in the tax shelters. Still other measures specifically target professionals to decrease their expected benefits or increase their expected costs from participating in tax shelters. The measures that target professionals might also, thereby, reduce the supply of these services (or increase their costs) for taxpayers who seek to participate in tax shelters.

6 Id., at 9.
Effects on Taxpayers

Several new measures focus on taxpayers’ incentives to engage in tax shelters. Congress and the IRS have closed loopholes to strip the potential benefits from participating in certain tax shelters. However, most of the new measures decrease the likelihood that taxpayers will keep their benefits from entering shelters or increase the likelihood that taxpayers will incur costs from engaging in tax shelters.

Decrease Potential Benefits From Tax Shelters

Several measures eliminate the benefits of specific transactions. Congress continues to enact “revenue raisers” to close “loopholes” in existing law. Amendments to the Code now prohibit certain identified tax shelters.

In addition, the IRS has listed transactions as “tax avoidance transactions” (i.e., “listed transactions”). By listing a transaction, the IRS is advising taxpayers not to expect the purported benefits from entering the transaction.

However, identifying the abuses, and amending the law to prevent abuses, is difficult. In addition, Congress generally prefers to change the tax laws only prospectively, in order to promote predictability in the income tax rules.

Decrease Probability That Tax Benefits Will Be Permitted

Several measures decrease the likelihood that taxpayers will achieve the benefits from tax shelters, most notably the new disclosure requirements to alert the IRS to suspect transactions.

First, the IRS has identified certain “reportable transactions” as suspicious enough to require taxpayers to disclose the transactions and advisors to register them. Additionally, advisors must maintain and turn over to the IRS lists of investors who invest in these reportable transactions. As explained in the regulations, “[t]he fact that a transaction is a reportable transaction shall not affect the legal determination of whether the taxpayer’s treatment of the transaction is proper.” However, these disclosures by taxpayers and their advisors presumably will attract IRS attention and should increase the probability of audit and disallowance of the benefits.

Second, taxpayers who prepare financial statements must include further detail on their tax returns if they report financial and taxable income differently. There now is a new Schedule M–3 that expands the reporting that had been required on the longstanding Schedule M–1 to include the source of financial information, reconciliation of the taxpayer’s worldwide net income (or loss) according to the income statement, and reconciliation of the net income (or loss) according to the income statement of the U.S. consolidated tax group.

Finally, those taxpayers who prepare financial statements also must disclose their tax accrual workpapers to the IRS if they enter into “listed transactions” (i.e., the tax avoidance transactions that are identified by the IRS). Tax accrual workpapers generally document the reason for, and the size of, the tax reserve (i.e., the reserve for tax liabilities that appears on audited financial statements). Access

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8 Treas. Reg. §§ 301.6011–4 and 301.6111–2 (Feb. 2003). In addition to listed transactions, five other categories of “reportable transactions” exist, i.e., (1) transactions offered under conditions of confidentiality, (2) transactions with contractual protection, (3) transactions with a significant book–tax difference, (4) loss transactions, and (5) transactions with a brief asset holding period. Treas. Reg. § 1.6011–4(b). See Treas. Reg. at § 1.6011–4(b).
9 Treas. Reg. § 1.6112–1 (February 2003).
10 Treas. Reg. § 1.6011–4(a) (February 2003).
to these documents would give the IRS additional information with which to challenge suspect transactions and impose penalties.

Administratively, the IRS plans to capitalize on these new disclosures and to shift its resources to addressing tax shelters. The IRS has created an Office of Tax Shelter Analysis (“OTSA”) specifically responsible for analyzing disclosed information relating to tax shelter activity and identifying abusive transactions.\(^\text{13}\)

Additionally, the IRS has increased the proportion of its examination resources devoted to tax shelters and has created an Enforcement Committee to guide IRS enforcement strategies.\(^\text{14}\)

Increase Potential Costs from Tax Shelters

As discussed above, taxpayers who enter suspect transactions will incur additional costs from the new disclosure rules. Advisors and other participants also will incur additional costs from the new disclosure rules, as well as other new burdens (see discussion of professionals below). The professionals may pass through their costs to taxpayers. As a result, taxpayers will incur substantially larger direct and indirect costs to enter a tax shelter.

Importantly, the level of penalties is unchanged. As discussed in the next section, Congress substantially revamped the penalty rules, making them much more likely to be applied. Congress, however, left the size of the penalties virtually untouched—there still is the standard 20 percent penalty for an underpayment of taxes that is substantial (or is attributable to negligence) and a 75 percent penalty for fraud (which is rarely asserted).

In recent legislation, Congress increased the effective cost to taxpayers to secure opinions to protect against penalties.\(^\text{15}\)

A common practice in the late 1990s was for advisors to charge fees contingent upon the tax benefits being sustained. Such contingent fees had reduced the expected cost of opinions by eliminating the cost of the opinion in the event of disallowance of tax benefits. Under the new legislation, taxpayers cannot rely for purposes of penalty protection on advice from advisors compensated by contingent fees.

Increase the Likelihood That Penalties Will Be Incurred

Some of the same measures that reduce the likelihood that tax benefits will be realized (such as disclosure and increased enforcement) also increase the likelihood that taxpayers will incur related penalties. For example, the disclosure requirements, which are expected to lead to more effective audits, also should lead to the discovery of more abusive transactions for which penalties are appropriate.

In addition, the IRS is pursuing tax penalties more aggressively in the field. In September 2004, the IRS reminded its examining agents to consider, develop and impose penalties.\(^\text{16}\)

The IRS also directed its Appeals Division, the division that attempts to settle tax disputes prior to litigation, to evaluate penalties independently and not trade penalties to settle disputes.\(^\text{17}\)

Congress also stripped away defenses to penalties for reportable transactions, which also should increase the application of penalties. As of October 2004, a different accuracy–related penalty applies to understatements attributable to report-

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\(^{17}\) Id.
able avoidance transactions ("RATs"), which are reportable transactions with a significant tax avoidance purpose. The RATs penalty is 20 percent of the understatement if the transaction is disclosed, and 30 percent if the transaction is not disclosed. There are fewer defenses to these penalties than under present law, because taxpayers cannot avoid the penalties by relying on certain disqualified opinions (which include opinions based on unreasonable factual or legal assumptions) or on disqualified advisors (which include certain advisors who participate in the organization, management, promotion, or sale of the transaction).

**Effects on Professionals**

Recent developments have removed incentives for other participants to participate in tax shelters. Importantly, the new developments above that target taxpayers’ choices also decrease the expected benefits to professionals of providing shelter services. As taxpayers’ net expected benefits from tax shelters fall, taxpayers may reduce their demand for the tax shelter services of professionals (promoters, facilitators, accommodation parties and advisors).

Meanwhile, several other measures specifically target the incentives of certain professionals to participate in tax shelters. These measures either decrease the expected benefits, particularly fees, or increase the expected costs related to providing tax shelter services.

**Promoters**

*Decreased expected benefits*

Promoters can expect fewer benefits from creating and marketing tax shelters. As noted earlier, disclosing reportable transactions will increase the likelihood of audit of the customer, which may decrease the value of the transaction to the promoter, especially if the transaction may be disclosed to competitors (which may be necessary, for example, to avoid the transaction being classified as a reportable transaction). After disclosure, a tax saving transaction becomes less confidential and proprietary, and a promoter is likely to charge less for the strategy than had the transaction never been disclosed.

Additionally, promoter audits and resulting injunctions should decrease promoters’ expected benefits from tax shelters. An audit increases the probability that the IRS will find evidence of inappropriate behavior, such as failing to register reportable transactions or maintain lists of investors in those transactions, and will seek an injunction against the promoter. A promoter subject to such injunctions is barred from marketing and collecting fees from tax saving strategies. To “identify and address promoter activity,” the IRS created a Promoter Lead Development Center in 2002 that monitors the Internet to identify promoters and develops cases for injunctive investigations. As of April 2005, the government had brought suit against more than 130 tax shelter promot-

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20 Transactions offered under conditions of confidentiality comprise one of the six categories of reportable transactions under Treas. Reg. § 1.6011–4(b).
ers, securing injunctions against more than 100. Additionally, the IRS has been investigating another 1,000 promoters for possible referral to the Justice Department.

**Increased expected costs**

Other measures increase promoters’ expected costs from engaging in tax shelters. As material advisors, promoters must devote time and effort to fulfilling their obligations under the regulations to register reportable transactions and maintain lists of investors in those transactions. Furthermore, for failure to register a reportable transaction, a new non-disclosure penalty attaches of up to 50 percent of the gross income derived from the advice. In addition, a new penalty of $10,000 per day applies for a failure to turn over an investor list.

Additionally, promoters face larger monetary penalties for peddling tax shelters. A “penalty on promoters of tax shelters” applies when a party organizes or participates in the sale of any interest in a plan or arrangement and, in that regard, makes a false or fraudulent statement or grossly exaggerates the value of property or services. As of October 2004, this penalty for promoting abusive tax shelters has no limit, increasing to 50 percent of the gross income derived from promoting the shelter, compared to $1,000 previously. The promoter audits discussed earlier in turn increase the probability that this penalty will attach.

Negative publicity comprises yet another cost that promoters may face if they promote tax shelters. For example, in a report released earlier this year, the Senate Subcommittee castigated certain promoters for mass marketing tax shelters to taxpayers. IRS Commissioner Mark Everson likewise emphasized the deterrence effects of negative publicity from injunctive actions, which are designed to stop a promoter from continuing to market tax shelters. According to the Commissioner, “Most of what we do is not public. When we go out at somebody, it’s not known that some fat cat is being audited who is going to end up giving back $10 million. But when you do a civil injunction, the word gets out, so it has a good positive impact on compliance beyond the narrow impact.”

Promoters who market tax shelters also risk bearing the costs of lawsuits brought by disgruntled taxpayers who have had to pay penalties in connection with tax shelters sold by promoters. Several promoters already are facing such lawsuits, which attract negative publicity, are costly to defend, and are even more costly in the event of a decision in favor of the taxpayer.

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23 Id.
24 Treas. Reg. §§ 301.6111–2 and 301.6112–1. A material advisor is any advisor who provides any material aid or advice in connection with organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction and who earns related gross income in excess of $250,000. I.R.C. § 6111(b)(1).
26 Id. at, § 6708(a).
27 I.R.C. § 6700.
Facilitators

*Decreased expected benefits*

With fewer tax shelters, less need for the services of facilitators will exist. However, as a result of the several anti–shelter measures targeted at other players, fees for facilitating transactions should diminish.

Facilitators may (or may not) know that their assistance is advancing a tax shelter, especially if they are entering into a transaction in the ordinary course of their business—and for their customary fees. For example, an investment banker acting as the counter–party in what may seem to the banker to be another routine derivatives transaction may not know about the related tax benefits. As a result, presumably, there are no current proposals to take away the fees of participants who merely facilitate a suspect transaction.

*Increased expected costs*

Like promoters, facilitators risk negative publicity if they participate in tax shelters. Noting that many tax shelters could not have been executed without the “active and willing participation” of facilitators, the Senate Subcommittee’s report specifically identified and criticized certain facilitators for their involvement in tax shelters.31

Accommodation Parties

*Decreased expected benefits*

Analogous to facilitators, accommodation parties stand to lose accommodation fees because of the lower incidence of tax shelters resulting from measures directed at other players. These measures should diminish the participation of accommodation parties in these transactions.

More targeted measures may be in order for accommodation parties than for facilitators, however. Unlike facilitators, for whom tax shelter transactions are part of the regular course of business, tax–exempt entities ordinarily do not participate in transactions in which they assume income. Consequently, the IRS has renewed its enforcement endeavors in the tax–exempt sector, which should suppress the role of accommodation parties. Commissioner Everson has stated that the use of accommodation parties in tax shelters is one of the “most significant compliance problems” in the area of exempt organizations.32 In part to discourage the use of tax–indifferent entities as accommodation parties in tax shelters, the IRS increased the proportion of its enforcement resources allocated to exempt organizations. In 2004, the IRS added 70 new agents to conduct examinations of exempt organizations. In addition, by September 2005, IRS staffing devoted to examinations of exempt organizations will have increased by 30 percent over the prior two years.33

*Increased expected costs*

Perhaps because accommodation parties, like facilitators, participate in tax shelters at the behest of other parties, accommodation parties face few sanctions for their participation in tax shelters despite the increased IRS enforcement endeavors against exempt organizations.

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33 Id.
34 Id.
However, like the promoters who enlisted their involvement, accommodation parties also risk negative publicity from their involvement in tax shelters. For example, the Senate Subcommittee has specifically identified certain tax-exempt entities and criticized them for their roles as counter-parties in tax shelters. Such negative publicity may be especially destructive to tax-exempt entities, since donors may be less inclined to donate to discredited entities.

Advisors

Decreased expected benefits

Advisors who participate in reportable transactions could earn fewer fees from providing tax advice as a result of certain new measures. If such advisors were treated as disqualified advisors, their opinions would provide no value to taxpayers in protecting against penalties.

Increased expected costs

Advisors who participate in tax shelters bear some of the same new costs as promoters. Advisors must incur administrative costs in satisfying their obligations to register reportable transactions and maintain lists of investors in those transactions. Otherwise, advisors must pay penalties.

Like promoters, advisors also risk negative publicity if they advise on tax shelters. For example, the Senate Subcommittee rebuked certain advisors for working closely with promoters to design shelters, writing generic opinions to multiple taxpayers, and charging fees proportional to the tax savings.

Furthermore, advisors may also incur costs related to lawsuits brought by disgruntled taxpayers who blame the advisors for penalties incurred in connection with tax shelters. Such lawsuits would be costly and hurt the advisors’ reputation among the taxpayers upon whom advisors depend for business.

In addition, advisors who issue advice in support of tax shelters risk professional sanctions. Revisions to the Treasury’s rules for practice before the IRS impose new responsibilities on advisors and sanctions for failure to meet those responsibilities. A broad category of advice, including opinions issued to protect against penalties, must include required analysis and disclosures. In particular, the advice must identify and consider all relevant facts, consider all significant tax issues, and not rely on any unreasonable assumptions. In addition, the advice must disclose whether the advisor has a relationship with a promoter, or the opinion cannot protect against penalties. Importantly, advisors face liability for violations of these rules, particularly censure, suspension, or disbarment from practice before the IRS, as well as fines.

At the same time, advisors who violate the Treasury’s rules for practice before the IRS bear a greater risk of sanctions as a result of the reinvigoration of the Office of Professional Responsibility ("OPR"), which enforces these rules and oversees the conduct of those who practice before the IRS. The IRS doubled the staff of the

OPR in 2003, and the director sits on the IRS Enforcement Committee.  

**Auditors**

*Decreased expected benefits*

Auditors’ ability to earn fees from providing tax shelter services to audit clients is limited. Under the Sarbanes–Oxley Act, auditors cannot provide legal services to audit clients. Thus, the Act essentially constrains the ability of auditors to earn fees by acting as advisors.

Although auditors may continue to provide tax services to audit clients under the Act, other measures effectively restrict the types of tax services auditors can provide and their related fees. First, certain types of tax services, such as providing tax advice in connection with planning a transaction, could be considered impermissible legal services. Second, a public company’s Audit Committee must pre-approve the services, and thus will be held accountable for this approval. In this regard, Committees have authority under the Act to engage independent counsel and advisors, who may caution against the taxpayer’s hiring an auditor to provide tax services. Third, the newly created Public Company Accounting Oversight Board (“PCAOB”), created by the Sarbanes–Oxley Act, has prohibited auditors from planning, marketing or opining on aggressive tax positions for an audit client. Finally, under new PCAOB rules, auditors no longer may provide tax services to executives of audit clients.

*Increased expected costs*

Auditors who flout their new obligations above and advise on tax shelters risk professional sanctions and penalties. Auditors of public companies now are subject to oversight by PCAOB, which has the authority to impose sanctions against auditors for violations of the Sarbanes–Oxley Act. PCAOB has the authority to revoke audit registration and impose fines of up to $15,000,000.

In addition, auditors who participate in tax shelters risk negative publicity. For example, auditors were among the several parties to tax shelters criticized by the Senate Subcommittee earlier this year. The Senate Subcommittee identified and rebuked several auditors for acting as promoters to design and aggressively market tax shelters.

Furthermore, advisors who act as promoters or advisors on tax shelters also risk the negative publicity and monetary costs of defending against lawsuits brought by discontented taxpayers. Certain auditors already are facing such lawsuits.

**WHAT REMAINS TO BE DONE?**

A variety of new measures discourage taxpayers and professionals from participating in tax shelters. These new measures either decrease the expected benefits or increase the expected costs to taxpayers and professionals of such participation. The majority of measures aims to deter taxpayers from taking part in tax shelters, which indirectly deters professionals.
by reducing the demand for tax shelter services. Additional measures specifically constrain the incentives of professionals to provide tax shelter services.

To deter tax shelter involvement even more, Congress might further decrease the expected benefits derived from tax shelters. Congress might continue to close loopholes in the Code giving rise to tax shelters or try to simplify the tax rules. Alternatively, Congress might add a general anti–abuse rule that overrides any statute in instances of misuse. Or Congress could strengthen the judicial requirement that transactions have economic substance to be respected.

However, as discussed earlier, identifying abuses and tailoring statutory amendments to have the desired deterrent effect is challenging. Moreover, identifying an abuse, or labeling a transaction devoid of economic substance, is difficult, as evidenced by the struggle of many different courts to grapple with these notions.

Congress could try to increase the likelihood of discovery of tax shelters, both to reduce the likelihood of benefits and increase the likelihood of costs (i.e., penalties). Most directly, Congress could increase the IRS’s budget to improve enforcement of the disclosure rules. In 2005, the IRS’s budget increased by only 0.5 percent, notwithstanding requests for more. For 2006, the Administration has requested a 4.3 percent and 8 percent increase in the IRS overall budget and enforcement budget, respectively. However, given the many competing demands for government funds, the approval of this budget request is difficult politically.

The IRS could extend the disclosure rules further in order to increase discovery of tax shelters. However, two problems arise. First, the IRS may be unable to process all the information required by the existing disclosure rules. The IRS’s limited resources increase this danger. With essentially the same tight budget, the IRS must now process scores of new disclosures from taxpayers, promoters and advisors, as well as implement the several other anti–shelter measures discussed above.

A second problem with requiring more disclosure is that extending the new disclosure rules may burden legitimate tax planning, not just tax shelters. Already, some complain that the reportable transaction rules may hinder legitimate business transactions. Despite real business needs for a particular transaction, taxpayers may be reluctant to proceed lest the transaction be characterized as a reportable transaction and result in greater administrative costs (and attract negative IRS attention in audit).

In light of the limitations of the IRS’s budget on enforcement, the IRS might consider public disclosure of reportable transactions (outside of the IRS), with confidential taxpayer information removed. For example, the IRS could require taxpayers to submit both complete and redacted (to remove taxpayer–specific information) disclosures of reportable transactions to the Office of Tax Shelter Analysis, which could share the redacted versions with the public. Promoters might be less inclined to devise tax shelters if they knew that they would lose proprietary rights to the shelters through public disclosure. At the same time, taxpayers might not want to invest in transactions that had been the subject of public scrutiny after disclosure. The Government might also find such scrutiny helpful in tailoring its anti–shelter campaign.

Given the hurdles to success of measures that target potential benefits from tax shelters or the chance of detection

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or of imposition of penalties, perhaps Congress could increase the potential costs of tax shelters by raising the level of penalties.

Congress has leeway to increase the level of penalties faced by taxpayers who engage in tax shelters. Provided they furnish the required disclosure, taxpayers who engage in reportable transactions with a significant tax avoidance purpose still face penalties of only 20 percent of understatement of tax.\(^50\) However, the IRS and courts recently have shown a willingness to assess and sustain higher penalties, applying an obscure 40 percent gross overvaluation penalty to a wide range of transactions (the 40 percent penalty originally was expected to apply only to taxpayers who inflate the value of property contributed to charity).\(^51\) Congress could avert this contradiction of congressional intent by increasing the 20 percent penalty for understatements attributable to transactions with a significant tax avoidance purpose.

In addition, Congress could impose penalties on ancillary parties to tax shelters, such as facilitators and accommodation parties, in certain instances. Facilitators, who now face no penalties, could confront penalties if they knowingly participate in a tax shelter. Likewise, accommodation parties who knowingly participate in tax shelters could face sanctions. The Senate Finance Committee has proposed a 100 percent tax on all accommodation fees or other direct benefits if a tax–exempt entity acts as an accommodation party.\(^52\) The Committee has also proposed revocation of tax–exempt status if a tax–exempt entity acts as an accommodation party to a reportable transaction with a significant tax avoidance purpose.\(^53\)

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\(^{53}\) *Id.*