Comments

Regulations Against Corporate Tax Shelters: Should We Keep Them?

By Cecilia Chui*

In the 1993 motion picture The Firm, ambitious law school graduate and first year associate Mitch McDeere was assigned to a tax planning project for one of the firm's clients. In trying to determine how aggressive the planning should be, Mitch asked his partner and mentor, Avery Tolar, how far he should bend the law. Avery's response was, "as far as you can without breaking it."

Although this scenario is from a movie, it is not far from reality. American taxpayers frequently try to create ways to reduce their income tax liabilities. As Judge Learned Hand stated, "[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." Because of the desire to keep taxes as low as possible, aggressive tax planning has always been an important characteristic of the American tax system. Indeed, "[p]roviding sophisticated tax reduction advice to clients has become a big business for account[ants] . . . and lawyers." Some accounting, investment banking, and law firms have "departments staffed with highly compensated professionals who devote all their efforts to gen-

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2. See id.
3. See id.
4. Id.
erating tax shelter products, an expensive exercise which they would not undertake if it were not lucrative."8

Corporate tax shelters have become popular in the last decade for a number of reasons. First, tax shelters for individuals were effectively eliminated by Congress in 1986 by the passive loss rules,9 whereas tax shelters for corporations survived that tax reform.10 Second, there has been a greater focus on corporate earnings.11 Corporate chief financial officers generally wish to increase net earnings for their shareholders, and one way to do this is to reduce the effective tax rates. In such an environment, a transaction that provides a deduction for tax purposes without the corresponding deduction on the financial statements becomes very desirable.12

The risk-reward factor associated with utilizing a corporate tax shelter is a further reason for its increasing popularity. The Internal Revenue Service's ("IRS") audit resources have been insufficient to examine these types of transactions.13 If the low odds of being audited are taken into consideration, "the cost benefit analysis leans decidedly in favor of the . . . corporate tax shelter."14

Although some tax reduction products are based on sound interpretations of the tax laws, many depend on very aggressive interpretations.15 The Department of the Treasury16 ("Treasury") has concluded that the proliferation of corporate tax shelters has reached an unacceptable level.17 "[M]ost agree that corporate tax shelters are

10. See Trier, supra note 6, at 63.
11. See id.
12. See id.
13. See id.
16. "The IRS is one of [the] . . . bureaus in the Department of the Treasury." Michael I. Saltzman, IRS Practice and Procedure 1-4 (RIA 2d ed. 1991) (1981). The IRS administers the internal revenue laws, whereas the Department of the Treasury carries specific functions that have not been delegated to the IRS. See id.
a serious problem, current law is inadequate to address it and a viable solution must extinguish shelters before they are entered into, rather than relying on detection through current means or legislation that attempts to attack specific transactions."\(^{18}\) In response, the Clinton administration offered various proposals in 1999 to shut down abusive tax shelters.\(^{19}\) In February 2000, the Treasury issued three sets of temporary and proposed regulations targeting corporate tax shelters.\(^{20}\) These regulations "requir[e] promoters to register confidential corporate tax shelters and maintain lists of investors and requir[e] corporate taxpayers to disclose large transactions that have characteristics common to tax shelters."\(^{21}\) The Bush administration is working on expanding the initial efforts made by the Clinton administration to combat the issue of abusive tax shelters.\(^{22}\)

Part I of this Comment explores the history of corporate tax shelters and the abuse that led to the February 2000 issuance of the temporary and proposed regulations. Part I also provides examples of tax shelters that have been utilized by corporations. In addition, Part I discusses the general aspects of the regulations, their objectives, and the timing of when they may be finalized. Part II of this Comment analyzes the problems and concerns the temporary and proposed regulations present. Part III discusses changes practitioners have proposed to the regulations and suggests solutions to the problems discussed in Part II. This Comment concludes that alternative methods should be adopted in lieu of the temporary and proposed regulations—at a minimum, the regulations should be rewritten to provide more reasonable guidelines.

I. Background: An Overview of Corporate Tax Shelters

A. What Is a Corporate Tax Shelter?

Generally speaking, a tax shelter refers to a scheme that reduces a taxpayer's income tax liability. A tax shelter usually involves "an elaborate series of formal steps . . . contrived to lead to an unreasonably beneficial tax result, usually resulting from some defect or ambiguity
in the tax law." However, the Treasury's definition of corporate tax shelters is quite complicated: "Under current law, an arrangement is treated as a corporate tax shelter . . . if it has as a significant purpose the avoidance or evasion of Federal income tax." Although "[t]here is [actually] no precise definition of a corporate tax shelter," the following are some common characteristics:

(1) . . . a certain tax loss for an investment with little or no risk of economic loss; (2) . . . involve[ment] [of] a domestic corporation and a person in the zero tax bracket[,] [m]ost commonly . . . a foreign person not subject to [United States] tax . . . ; (3) . . . [seizure of an] advantage of a flaw in the tax law that allocates [to the zero-bracket tax payer] income in excess of economic income . . . leaving the domestic corporation with a loss in excess of economic loss; [or alternately] (4) . . . [a] play on structural flaws involving the taxation of corporate or partnership income, or the interaction of the [United States] tax system with foreign tax systems; (5) . . . [promotion] to Fortune 500 companies and large closely-held concerns; and (6) . . . [likelihood of being] shut down by legislative or administrative change soon after it is detected.

1. Tax Shelters Using Treasury Notes

Descriptions of several tax shelter products best illustrate the characteristics of corporate tax shelters and how they work. One product that has been promoted involves the use of Treasury notes. A corporation borrows money to buy Treasury notes with terms of three to five years, and then the corporation distributes the notes to its shareholders, who hold the notes until maturity and collect the principal. The shareholders take the position under Internal Revenue Code ("I.R.C.") section 301(b)(2)(B) that the amount of the dividend distributed is the fair market value of the notes distributed less the liability to which the notes were subject. After the distribution

23. Canellos, supra note 8, at 49.
24. Sawyers, supra note 18, at 568.
25. Bankman, supra note 14, at 1776.
26. Id. at 1777.
28. A bond "matures" when the debt or obligation becomes due. See BLACK'S LAW DICTIONARY 993 (7th ed. 1999).
29. See Sheppard, supra note 27, at 322.
30. I.R.C. § 301(b)(2)(B) (West 2000). This code section addresses the effects on recipients of a property distribution by a corporation. See id.
31. See Sheppard, supra note 27, at 322. In other words, the amount of dividend taxable to the shareholders is zero (or close to zero) because the Treasury notes are purchased
and before the notes mature, the corporation pays off the liability.\textsuperscript{32} Under this transaction, the corporation—if permitted by the IRS—effectively makes a tax free dividend distribution to its shareholders, thus avoiding the double taxation effect of corporate dividends.\textsuperscript{33}

2. **High-Basis Low-Value Tax Shelter**

Another type of corporate tax shelter is the “High-Basis Low-Value Tax Shelter.”\textsuperscript{34} This involves a profitable domestic parent corporation,\textsuperscript{35} its subsidiary,\textsuperscript{36} and a foreign party whose gains and losses on sales of securities are not subject to United States taxes.\textsuperscript{37} The foreign party contributes to the subsidiary a security held at a loss position,\textsuperscript{38} for example, worth $10 but with a cost basis\textsuperscript{39} of $50.\textsuperscript{40} In exchange, the foreign party receives nonvoting preferred stock\textsuperscript{41} worth slightly more than the security contributed, for example, $11.\textsuperscript{42} The subsidiary then sells the security and recognizes a loss of $40.\textsuperscript{43} The subsidiary treats this loss as a “section 988 transaction’ . . . [and] using the borrowed money, and the fair market value at the time of distribution is approximately equal to the amount of debt owed.

\begin{itemize}
  \item 32. See id.
  \item 33. The following explains the “double taxation” concept:
    Corporations are generally treated as separate taxable entities under the IRC with their own sets of rules and their own tax schedules . . . . Because corporation income is taxed at the corporate level and again at the individual level if there is a distribution to the shareholders, it is sometimes said that corporations are subject to double taxation.

ROBERT W. HAMILTON & RICHARD A. BOOTH, BUSINESS BASICS FOR LAW STUDENTS 253 (2d ed. 1998).

  \item 34. Bankman, \textit{supra} note 14, at 1777.
  \item 35. A “domestic parent corporation” is one incorporated in the United States that usually owns at least 50% of another corporation. See BLACK’S LAW DICTIONARY 343–44 (7th ed. 1999).
  \item 36. A corporation is a “subsidiary” when another corporation has a controlling share of its stock. See BLACK’S LAW DICTIONARY 345 (7th ed. 1999).
  \item 37. See Bankman, \textit{supra} note 14, at 1777.
  \item 38. A “loss” occurs when the original cost of a security is greater than its later selling price. See BLACK’S LAW DICTIONARY 956 (7th ed. 1999).
  \item 39. A “cost basis” in the tax sense refers to “the cost of acquiring the property.” BLACK’S LAW DICTIONARY 145 (7th ed. 1999).
  \item 40. See Bankman, \textit{supra} note 14, at 1777. The security is an option in the currency of a nation in which the foreign party does not conduct business operations.” \textit{Id}.
  \item 41. “Preferred stock is usually a stock with a prior (but limited) claim to distributions ahead of the common shares.” HAMILTON & BOOTH, \textit{supra} note 33, at 143. “Nonvoting” means the shares are not “entitled to vote for the election of directors and on other matters coming before the shareholders . . . .” \textit{Id} at 306.
  \item 42. See Bankman, \textit{supra} note 14, at 1777.
  \item 43. See id.
[a]s a result, the loss is ordinary rather than capital. Since it is treated as an ordinary loss, it can be used to offset ordinary income generated by the subsidiary. In essence, the subsidiary buys from the foreign party $40 worth of deductions for $1. At the existing highest corporate marginal tax rate of 35%, the subsidiary saves a net $13 from this transaction.

3. Installment Sale Shelter

A third form of tax shelter is commonly referred to as the "Installment Sale Shelter." This tax shelter also involves a person, X, not subject to United States taxes, who enters into a partnership with a domestic corporation. The partnership allocates over 80% of its gains and losses to X. The partnership purchases securities for $175, and then subsequently sells the securities for $140 cash and a contingent six year note with a value of $35. Because of the receipt of the contingent six year note, under the installment sale method, only one-sixth of the $175 cost basis is allocated to the $140 cash payment received in the first year. Therefore, a gain of $110 is recognized in

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44. Id. Section 988 transactions relate to foreign currency exchanges, and gains and losses from such transactions are treated as ordinary income or loss. See Robert E. Meldman & Michael S. Schadewald, A Practical Guide to U.S. Taxation of International Transactions 237-39 (2d ed. 1997). A "capital loss" is "[t]he loss realized upon selling or exchanging a capital asset," and an "ordinary loss" is "[a] loss incurred from the sale or exchange of an item that is used in a trade or business." Black's Law Dictionary 956-57 (7th ed. 1999). A corporation can only deduct capital losses to the extent of capital gains. See I.R.C. § 1211 (a) (West 2000). Therefore, characterization as "ordinary loss" is generally more favorable to a corporation.

45. See Bankman, supra note 14, at 1777.

46. See id.

47. The "marginal tax" rate is "the rate applicable to the last dollar of income earned by the taxpayer." Black's Law Dictionary 1475 (7th ed. 1999).


49. A $40 loss multiplied by 35% taxes saved, less $1 transaction cost (additional savings may be available from any applicable state corporate income tax).

50. Bankman, supra note 14, at 1779.

51. See id. This was basically the product sold by Merrill Lynch & Co., Inc. to Colgate-Palmolive Co. in the late 1980s and early 1990s. See ACM P'ship v. Comm'r, 157 F.3d 231 (3d Cir. 1998); see also ACM P'ship v. Comm'r, 73 T.C.M. (CCH) 2189 (1997).

52. See Bankman, supra note 14, at 1779.

53. See id. at 1779-80. The note is a London Interbank Offered Rate ("LIBOR") note. See id. at 1780. "LIBOR . . . is the interest rate that most international banks dealing in Eurodollars charge each other for large loans." ASA Investerings P’ship v. Comm’r, 76 T.C.M. (CCH) 325, 326 n.1 (1998).

54. An "installment sale" exists "when at least one payment of the total purchase price is to be received after the close of the taxable year" in which the sale transaction occurred. Freeland et al., supra note 9, at 825.

55. See Bankman, supra note 14, at 1780.
the first year, of which over 80% is allocated to X. The remaining basis of $145 is left to offset the $35 note, which creates a built-in loss of $110. After allocating over 80% of the first year gain to X, who is not subject to United States taxes, the partnership redeems X’s share for a fee. The end result is that the domestic corporation will be able to recognize the $110 built-in loss over the next six years to offset other gains. In essence, the domestic corporation purchases a $110 deduction for a small fee in redeeming X’s share.

B. Abuse Leading to the Treasury’s Issuance of the Corporate Tax Shelter Regulations

1. Treasury’s Loss of Tax Revenue

As illustrated above, tax revenues can be greatly diminished through the use of corporate tax shelter transactions. For example, “in 1995 [40%] of all companies with more than $250 million in assets or $50 million in gross receipts paid less than $100,000 in federal income tax.” However, because economic information concerning tax shelters is largely unreliable, “[i]t is difficult to quantify the extent of the tax shelter problem.” It is estimated between $3 billion and $30 billion of tax revenue is lost annually due to such tax shelters. Brief analyses of ACM Partnership v. Commissioner, ASA Investering Partnership v. Commissioner, and Compaq Computer Corp. & Subsidiaries v. Commissioner can help put the tax shelter problem into perspective.

56. See id.
57. See id.
58. See id. The redemption fee is an amount which the partners of the partnership agree to pay the exiting partner.
59. See id.
60. A detailed discussion of tax basis, gains and losses, and installment sales is beyond the scope of this Comment. For an excellent resource on these subjects, see James J. Freeland et al., Fundamentals of Federal Income Taxation (11th ed. 2000).
61. See discussion supra Part I.A.
63. Sawyers, supra note 18, at 569.
64. See id. “Some estimates indicate that corporate tax shelters cost the federal government ten billion dollars annually in lost income tax revenue.” Casarona, supra note 62, at 111. A Forbes Magazine article in March 2001 estimated that “the Internal Revenue Service lost approximately $200 billion per year because of tax shelters.” Bergin et al., supra note 22, at 1295.
65. 157 F.3d 231 (3d Cir. 1998); see also ACM P’ship v. Comm’r, 73 T.C.M. (CCH) 2189 (1997).
67. 113 T.C. 214 (1999); see also No. 00-60648, 2001 U.S. App. LEXIS 27297 (5th Cir. Dec. 28, 2001).
These cases illustrate the extent of the loss of tax revenues and the actual tax reduction schemes used.

a. **ACM Partnership v. Commissioner**

In *ACM Partnership*, Colgate-Palmolive Co. ("Colgate") had a gain of approximately $105 million in the 1988 tax year from the sale of a subsidiary.\(^{68}\) To provide a way to shelter part of Colgate's sizeable gain, Merrill Lynch & Co., Inc. ("Merrill") approached Colgate to promote its contingent installment sale transaction ("CINS") plan.\(^{69}\) The CINS plan involved the formation of a partnership, ACM, with a foreign bank not subject to United States taxes as an 82.63% partner, Colgate as a 17.07% partner, and Merrill as a 0.29% partner.\(^{70}\) ACM purchased $205 million of notes from Citicorp, and three weeks later sold $175 million of the notes in a taxable installment sale.\(^{71}\) ACM received $140 million in cash and a present value of $35 million of LIBOR-based installment notes.\(^{72}\) Under the installment sale regulations, ACM realized $140 million in sales proceeds in the first year but was only able to use $29 million of its $175 million basis, thus reporting a net taxable gain of $111 million in year one.\(^{73}\) ACM then allocated 82.63% of this gain, totaling approximately $92 million, to the foreign bank; the remainder was allocated between Colgate and Merrill.\(^{74}\) The installment notes had a built in loss of $111 million.\(^{75}\) After the first year, ACM redeemed the foreign bank's partnership interest.\(^{76}\) The built in capital loss was essentially allocated to Colgate,\(^{77}\) which Colgate used to offset its $105 million of capital gain.

The United States Tax Court concluded that the CINS plan did not have any economic substance, and the court was "convinced that tax avoidance was the reason for the partnership's purchase and sale

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68. See *ACM P'ship*, 73 T.C.M. (CCH) at 2191.
69. See id. at 2190–91.
70. See Steven M. Surdell, *ACM Partnership—A New Test for Corporate Tax Shelters?*, 75 TAX NOTES 1377, 1379 (1997). The foreign bank was a Netherlands Antilles corporation, and it was not subject to either United States tax or taxes in the Netherlands Antilles. See id. at 1379–80.
71. See id. at 1379.
73. See Surdell, *supra* note 70, at 1379.
74. See id. at 1379–80.
75. See id. at 1380.
77. See Surdell, *supra* note 70, at 1380; see also discussion *supra* Part I.A. The actual capital loss allocated to Colgate totaled approximately $84.5 million. See *ACM P'ship*, 73 T.C.M. (CCH) at 2213.
of the Citicorp Notes.”78 The Tax Court held that ACM was “not entitled to recognize a phantom loss from a transaction that lacks economic substance.”79 On appeal, the court of appeals agreed with the Tax Court and held that the “transaction[ ] . . . did not have sufficient economic substance to be respected for tax purposes.”80 This decision got the attention of the corporate community, because “[b]y applying the economic substance doctrine . . . the Tax Court attempted to clarify when a corporate liability management plan becomes a tax abuse scheme.”81 “The court found that the carefully crafted transactions were not driven by the stated liability management purpose, but rather by tax avoidance goals.”82

b. ASA Investerings Partnership v. Commissioner83

The transaction in ASA Investerings was similar to the CINS plan in ACM Partnership.84 However, in addition to the ASA partnership redeeming a foreign partner’s interest,85 the domestic corporation purchased a portion of the two foreign partners’ interest to become the majority partner.86 ASA then distributed the notes to the domestic corporation, which in turn sold them at a loss.87 The domestic corporation reported a total tax loss of approximately $592 million on the sale of the notes.88

The Tax Court in ASA Investerings concluded that ASA was not a valid partnership.89 The court reasoned that “if an arrangement does not put all parties ‘in the same business boat, then they cannot get

78. ACM P’ship, 73 T.C.M. (CCH) at 2215.
79. Id.
82. Id. at 392.
83. 76 T.C.M. (CCH) 325 (1998).
85. See discussion supra Part I.B.1.a; see also ASA Investerings P’ship v. Comm’r, 76 T.C.M. (CCH) 325, 331 (1998).
86. See ASA Investerings, 76 T.C.M. (CCH) at 330.
87. See id. at 330–31.
88. A loss of $196 million was recognized upon the initial sale of a portion of the notes, and $396 million of loss was recognized on the sale of the remainder. See id. at 331–32.
89. See id. at 333. Another case involving essentially the same transaction was recently decided in favor of the taxpayer. See Boca Investerings P’ship v. United States, 167 F. Supp. 2d 298 (8th Cir. 2001). For a critique of the Boca decision, see Lee A. Sheppard, Corporate Tax Shelters: Getting Away from the Script, 93 TAX NOTES 460 (2001).
into the same boat merely to seek . . . [tax] benefits.'"

Without the partnership, all of the gain in the first year of the installment sale, originally allocated to the foreign partner, was taxable to the domestic corporation instead.

c. Compaq Computer Corp. & Subsidiaries v. Commissioner

Twenty-First Securities Corporation ("Twenty-First"), an investment firm, learned that Compaq Computer Corporation ("Compaq") had a recognized gain from an unrelated transaction, and contacted Compaq to solicit Compaq's participation in "'strategies that take advantage of a capital gain,' including . . . the [American Depository Receipt ("ADR")]) arbitrage transaction." Compaq went forward with the ADR arbitrage transaction. The ADR transaction involved the purchase of cum dividend shares of Royal Dutch Petroleum Company (a Netherlands company), and a resale of the ex dividend to the same seller approximately an hour later.

Since Compaq was the shareholder of record on Royal Dutch's dividend record date, Royal Dutch paid a dividend to Compaq of approximately $22.5 million, less 15% foreign tax withholding of approximately $3.3 million. Compaq reported the $22.5 million dividend as income and claimed the corresponding foreign tax credit on its corporate income tax return. In addition to reporting the dividend income, Compaq also reported a capital loss of

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90. ASA Investering, 76 T.C.M. (CCH) at 333–34 (quoting Comm'r v. Culbertson, 337 U.S. 733, 754 (1949) (Frankfurter, J., concurring)).
91. See Lipton, supra note 84, at 17–18.
93. Id. at 215. "An ADR (American Depository Receipt) is a trading unit issued by a trust which represents ownership of stock in a foreign corporation that is deposited with the trust. ADRs are the customary form of trading foreign stocks on [United States] stock exchanges . . . ." Id.
94. See id. at 216.
95. "Cum dividend' refers to a purchase or sale of a share of stock . . . with the purchaser entitled to a declared dividend (settlement taking place on or before the record date of the dividend)." Id. at 215.
96. "Ex dividend' refers to the purchase or sale of stock . . . without the entitlement to a declared dividend (settlement taking place after the record date)." Id. at 215–16.
97. See id. at 217–18. According to the New York Stock Exchange rules, the purchase trades were settled the next day, whereas the sale trades had settlement terms of five days. See id. at 217. Therefore, the purchase and sale transactions can be consummated on the same day cum and ex dividend, respectively.
98. See id. at 219. Pursuant to the United States-Netherlands Tax Treaty, a contemporaneous tax withholding is required to be remitted to the Netherlands Government when a Dutch company pays a dividend to a United States resident. See id.
99. See id. at 219.
$20.6 million from the sale of Royal Dutch stock ex dividend. On the surface, Compaq appeared to have reported a net increase in income of approximately $1.9 million from this transaction. However, it actually incurred a cost of over $1.4 million to purchase the $3.3 million of foreign tax credit.

The Tax Court noted that there is a “difference between (1) closing out a real economic loss in order to minimize taxes or arranging a contemplated business transaction in a tax-advantaged manner and (2) entering into a prearranged loss transaction designed solely for the reduction of taxes on unrelated income.” The Tax Court found that since “[t]he purchase and resale prices were predetermined,” and there was virtually no risk of price fluctuation because of the sale within an hour of the purchase, the transaction “was deliberately predetermined and designed by [Compaq] and Twenty-First to yield a specific result and to eliminate all market risks.” The Tax Court concluded that Compaq “was motivated by the expected tax benefits of the ADR transaction, and no other business purpose existed.” Therefore, the Tax Court found in favor of the IRS, disallowing the $3.3 million foreign tax credit. In addition, the Tax Court concluded that Compaq was negligent and assessed penalties. However, on appeal, the Fifth Circuit Court of Appeals concluded that this transaction had both economic substance and a non-tax business purpose, and reversed in favor of Compaq.

As the above cases illustrate, corporate tax shelters—if found to be legitimate—can reduce a significant amount of taxes. At the 35%

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100. See id. Compaq purchased the stock cum dividend at $888.5 million and sold it ex dividend at $867.9 million. See id.
101. A $22.5 million dividend less a $20.6 million capital loss. See id.
102. A $22.5 million dividend less $3.3 million taxes withheld nets to actual proceeds of $19.2 million. See id. Net dividend proceeds of $19.2 million less capital loss of $20.6 million from the stock sale transaction results in a net cost of $1.4 million. See id; see also id. at 223 (employing a different computational approach which leads to the same result).
103. Id. at 220.
104. Id. at 224.
105. Id.
106. Id. at 225.
107. See id. at 222–25.
108. See id. at 220.
109. See Compaq, 113 T.C. at 227. A taxpayer is negligent when he or she fails to make a reasonable attempt to comply with the provisions of the Internal Revenue Code. See I.R.C. § 6662(c) (CCH 2000).
marginal corporate income tax rate, if the ACM Partnership, ASA Inves-
terings, and Compaq Computer schemes were all allowed, the Treasury
would have lost combined tax revenues of over $200 million from
these companies.\textsuperscript{111} In addition, "[n]ot only do abusive corporate tax
shelters wrongfully deprive the federal treasury of revenues, but the
knowledge that some taxpayers are getting away with it encourages
others to pursue similar transactions."\textsuperscript{112}

2. Issuance of the Regulations

The Treasury has "several reasons to be concerned about the
proliferation of corporate tax shelters. These concerns range from the
short-term revenue loss to the tax system, to the potentially more
troubling long-term effects on [the] voluntary income tax system."\textsuperscript{113}
In an attempt to put an end to the proliferation of corporate tax shel-
ters, the Treasury issued three sets of temporary and proposed regu-
lations on February 28, 2000.\textsuperscript{114} These regulations pertain to
"registration of corporate tax shelters[,] . . . requirements to maintain
lists of investors in potentially abusive tax shelters[,] . . . and . . . tax
shelter disclosure statements."\textsuperscript{115}

Temporary Treasury Regulation section 301.6111-2T\textsuperscript{116} ("section
6111 regulation") implements the registration requirement of I.R.C.
section 6111(d).\textsuperscript{117} Commonly referred to as the "Registration Rules,"
the section 6111 regulations require confidential corporate tax shel-
ters to be registered with the IRS\textsuperscript{118} and "define[ ] a new type of confi-

\textsuperscript{111} The author computed the $200 million total as follows: $30 million dollars from
ACM Partnership ($84.5 million capital loss disallowed multiplied by 35%). See ACM P'ship
v. Comm'r, 73 T.C.M. (CCH) 2189, 2213 (1997). From ASA Inves terings, $170 million ($485
million total capital gains allocated to the two foreign partners not subject to United States
tax multiplied by 35%). See ASA Investerings P'ship v. Comm'r, 76 T.C.M. (CCH) 325, 330

\textsuperscript{112} Brion D. Graber, Comment, Can the Battle Be Won? Compaq, the Sham Transaction
Doctrine, and a Critique of Proposals to Combat the Corporate Tax Shelter Dragon, 149 U. PA. L.

\textsuperscript{113} Dep't of the Treasury, The Problem of Corporate Tax Shelters: Discussion,
Analysis and Legislative Proposals iii (July 1999), at http://www.ustreas.gov/taxpolicy/
library/ctswhite.pdf.

\textsuperscript{114} See Sawyers, supra note 18, at 571.

\textsuperscript{115} Id.


\textsuperscript{117} See Thomas M. Cryan et al., A Guide to the New Corporate Tax Shelter Regulations, 87
TAX NOTES 107, 108 (2000); see also I.R.C. § 6111(d) (CCH 2000).

\textsuperscript{118} See Kenneth W. Gideon & Christopher P. Bowers, The New Tax Shelter Disclosure
dential corporate tax shelter.”119 These regulations apply to confidential corporate tax shelters’ interests for sale after February 28, 2000.120

The list rules of Temporary Treasury Regulation section 301.6112-1T121 (“section 6112 regulations”) “require[ ] any person who organizes or sells any interest in a ‘potentially abusive tax shelter’ to maintain a list identifying each investor sold an interest in the potentially abusive shelter.”122 A transaction is potentially abusive if it has certain “characteristics common to tax shelters.”123 Finally, Temporary Treasury Regulation section 1.6011-4T124 requires a disclosure statement to be filed by any corporate taxpayer “that has participated, directly or indirectly, in a reportable transaction.”125 These regulations basically “require[ ] corporate taxpayers to disclose on their annual tax returns certain large transactions that have characteristics common to tax shelters.”126

“[T]here are three main objectives behind the regulations: Deterrence, . . . audit detection, . . . and reaction.”127 In general, these regulations are designed “to provide the [IRS] with better information about tax shelters and other tax-motivated transactions through a combination of registration and information disclosure by promoters and tax return disclosure by corporate taxpayers.”128 With these disclosure requirements, the IRS will receive “earlier notification than it generally [has] receive[d] . . . of transactions that may not comport with the tax laws . . . .”129 In addition to providing information, these regulations “are intended to discourage corporations from entering into questionable transactions and are expected to lead to better enforcement of existing anti-abuse rules.”130 Also, Congress believes these regulations will “improve economic efficiency, because investments that are not economically motivated, but that are instead tax-motivated, may reduce the supply of capital available for economically

120. See Cryan et al., supra note 117, at 108.
121. Temp. Treas. Reg. § 301.6112-1T.
123. NYSBATS Comments, supra note 119, at 1448.
126. NYSBATS Comments, supra note 119, at 1448.
127. Bergin et al., supra note 22, at 1295.
128. Sawyers, supra note 18, at 568.
129. Gideon & Bowers, supra note 118, at 261 (second alteration in original).
130. Marshall & Tello, supra note 21, at 207.
motivated activities, which could cause a loss of economic efficiency.\textsuperscript{131}

The regulations are currently at the proposed and temporary stages. After their initial issuance on February 28, 2000, the IRS modified them in August 2000\textsuperscript{132} and again in August 2001.\textsuperscript{133} Larry R. Langdon, the head of the IRS Large and Mid-Size Business Division, has "emphasized that it is important for the IRS to get more experience before moving to finalize the rules."\textsuperscript{134} The IRS Acting Chief Counsel has stated that "there was no real reason to finalize the [regulations in 2001] and that it might be good to see how they work for an additional year."\textsuperscript{135} Therefore, it is unclear when or even if these regulations will be converted from a temporary to a permanent form. However, though temporary as of the time of this Comment's publication, these regulations are applicable to corporate income tax returns filed after February 28, 2000.\textsuperscript{136}

II. Problems with the Regulations

There are a number of concerns with the temporary regulations. In general, practitioners feel that these "rules are administratively burdensome and the terms used are [too] broadly construed."\textsuperscript{137} These rules "fail to provide a clear standard to consistently or predictably judge alleged abuses."\textsuperscript{138} There are concerns that the current regulations would affect too many taxpayers, because these regulations concern more than just the "transactions entered into by 'large publicly traded companies.'"\textsuperscript{139} Many practitioners believe that these "regulations reach far beyond abusive tax shelters,"\textsuperscript{140} and that a "broadly defined law may curtail abusive corporate tax shelters at the expense of

\textsuperscript{131} Gideon & Bowers, supra note 118, at 261.
\textsuperscript{132} See Internal Revenue Service, IRS Revises Corporate Tax Shelter Regs., 88 Tax Notes 990, 990 (2000).
\textsuperscript{134} Sheryl Stratton, ABA Tax Section Meeting—IRS Pursues All Fronts in War on Abusive Tax Shelters, 90 Tax Notes 436, 436–37 (2001).
\textsuperscript{135} Bergin et al., supra note 22, at 1295.
\textsuperscript{136} See Cryan et al., supra note 117, at 107. In other words, the regulations are applicable to the 1999 tax year for calendar year corporate taxpayers, unless the corporation's return was filed by February 28, 2000.
\textsuperscript{137} Sawyers, supra note 18, at 572.
\textsuperscript{138} Casarona, supra note 62, at 130–31.
\textsuperscript{139} Sawyers, supra note 18, at 572.
\textsuperscript{140} Sheryl Stratton, Disclosure Regs: Overbroad, Burdensome, . . . and Effective?, 87 Tax Notes 1311, 1312 (2000).
legitimate business transactions."\textsuperscript{141} The American Institute of Certified Public Accountants\textsuperscript{142} ("AICPA") is also concerned that these regulations will affect most tax advisers due to the broad scope.\textsuperscript{143} In addition, these rules "suggest a significant shift in authority from Congress to the IRS."\textsuperscript{144} The following Sections address the specific problems related to the regulations.

\section*{A. Section 6111 Regulations—Registration Rules}

The section 6111 regulations require the organizer of a confidential corporate tax shelter to register with the IRS.\textsuperscript{145} The regulations require the organizer to provide information that identifies and describes the tax shelter and any benefits represented to investors.\textsuperscript{146} In addition, "[a]ny written materials presented in connection with an offer to participate in the shelter must be submitted . . . ."\textsuperscript{147}

Temporary Treasury Regulation section 301.6111-2T(a)(2) defines a confidential corporate tax shelter as any transaction—(i) [a] significant purpose of . . . which is the avoidance or evasion of Federal income tax, . . . (ii) [t]hat is offered to any potential participant under conditions of confidentiality, . . . and (iii) [f]or which the tax shelter promoters may receive fees in excess of $100,000 in the aggregate . . . .\textsuperscript{148}

The problems lie in the definition of what constitutes a "[t]ransaction . . . structured for avoidance or evasion of Federal income tax . . . ."\textsuperscript{149} A transaction is considered as structured for tax avoidance or evasion if it is substantially similar to a previously identified tax avoidance trans-

\begin{thebibliography}{99}
\bibitem{141} Casarona, \emph{supra} note 62, at 135–36.
\bibitem{142} An excerpt from the AICPA mission statement explains the organization's primary goals:

The American Institute of Certified Public Accountants is the national, professional organization for all Certified Public Accountants. Its mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients.

\bibitem{143} See Sawyers, \emph{supra} note 18, at 573.
\bibitem{144} Casarona, \emph{supra} note 62, at 140.
\bibitem{145} See Temp. Treas. Reg. \S 301.6111-2T(a) (2000); \emph{see also} I.R.C. \S 6111(a)(1) (CCH 2000).
\bibitem{146} See I.R.C. \S 6111(a)(2) (A)–(B) (CCH 2000).
\bibitem{147} Sawyers, \emph{supra} note 18, at 571.
\bibitem{149} Temp. Treas. Reg. \S 301.6111-2T(b).
\end{thebibliography}
action, or if “an important part of the intended results” is to produce income tax benefits.

The “important part of the intended results” category generally requires a promoter to register the transaction if producing federal tax benefits is “an important part of the intended results of the transaction,” and the promoter or registrant reasonably expects to present a similar transaction to more than one potential participant. “[N]o quantification of ‘an important part’ of a transaction appears in either the substantive rules or the examples.” Because it is unclear what level of importance to the taxpayer is necessary to meet the “important part” test, this test could potentially include a large number of transactions. Limiting the transactions to those that are reasonably expected to be presented to more than one potential participant does not narrow the scope much further—most promoters attempt to sell a transaction to as many taxpayers as possible to leverage the work they have already completed.

A transaction is not considered as structured for tax avoidance or evasion if the promoter “reasonably determines that there is no reasonable basis under Federal tax law for denial of any significant portion of the expected Federal income tax benefits from the transaction.” The problem with this standard is that “practitioners and promoters who have been willing to find a ‘reasonable basis’ for almost anything a tax shelter investor could be persuaded to buy must now determine whether a transaction must be registered using that same liberal standard of construction but applied in favor of the IRS.” The Treasury’s acting Deputy Assistant Secretary for Tax Policy has stated that this standard “is ‘intended to be a very high standard.’” What level of assurance is necessary to meet this “very high standard”? The IRS acting Chief Counsel “noted that the regulations provide disclosure rules, not substantive rules, so they don’t have to be that precise.” However, setting such an imprecise and high standard to qualify under this exception may lead to an over-inclusive re-

152. Gideon & Bowers, supra note 118, at 263.
154. Gideon & Bowers, supra note 118, at 263.
155. See NYSBATS Comments, supra note 119, at 1473.
156. See id.
157. Bergin et al., supra note 22, at 1295.
159. Bergin et al., supra note 22, at 1295.
sult, as promoters may disclose novel or routine transactions, especially at the low promoter fees threshold of $100,000.

B. Section 6112 Regulations—List Rules

Organizers of “any potentially abusive tax shelter” are required to keep a list identifying each taxpayer who was sold an interest in the tax shelter. I.R.C. section 6112 and the related regulations (collectively, “List Rules”) basically “allow[ ] the IRS to obtain the identity of investors in a ‘potentially abusive tax shelter’ without the requirement for a summons.”

One problem with this code section is determining who should be included on the investor list. “[T]he scope of transactions covered by the [List Rules] is far broader than the Registration Regulations,” because the List Rules apply to transactions that are marketed to any type of taxpayer, including both individuals and corporations. To reduce the potential of “requir[ing] every tax adviser . . . to keep a list for virtually all tax advice provided to clients,” the Treasury added two de minimis exceptions to the list requirements in August 2000. These exceptions are available if (1) less than $25,000 of total consideration was paid; or (2) the promoter reasonably believes that the transaction will not reduce a corporation’s income tax by more than $1 million in a single year or more than $2 million for any combination of years, or in the case of non-corporate taxpayers, $250,000 for any one year or $500,000 for any combination of years. If either exception applies, then the promoter is not required to include that taxpayer on the list.

Although these exceptions are helpful, they do not eliminate the over-inclusive nature of the proposed regulations. Under the section 6112 regulations, a participant is considered to have purchased an interest in the tax shelter if it has “paid consideration to an orga-

160. See NYSBATS Comments, supra note 119, at 1469; see also Gideon & Bowers, supra note 118, at 263.
162. See I.R.C. § 6112(a) (CCH 2000). “Potentially abusive tax shelter” is a transaction that is required to be registered under the Registration Rules of section 6111 Regulations. See I.R.C. § 6112(b)(1) (CCH 2000).
164. NYSBATS Comments, supra note 119, at 1453.
165. See id.
166. Stratton, supra note 134, at 1312.
167. See NYSBATS Comments, supra note 119, at 1453.
169. See id.
nizer . . . for information that is integral to participation in such tax shelter." There may still be many instances where a potential investor pays a fee to the promoter for information relating to participation in a tax shelter but never carries out the transaction.

Another problem is the type of information the promoter is required to maintain. The regulation contains a laundry list of information that must be provided by the promoter. One condition calls for "[a] detailed description of the tax shelter that describes both the structure of the tax shelter and the intended tax benefits for participants in the tax shelter." Such a requirement "will be time consuming and will clearly require review by the tax and non-tax lawyers involved for accuracy." Also, it is unclear how detailed an explanation of the structure is required by the proposed regulation.

C. Section 6011 Regulations—Disclosure Rules

The disclosure rules require "a corporate taxpayer that has participated in a 'reportable transaction' to attach a disclosure statement" to the income tax returns detailing which tax liabilities have been reduced as a result of its participation. The issue raised by these regulations is the minimum thresholds that must be met before a taxpayer is required to make such a disclosure. The disclosure regulations list five characteristics that are common in tax shelters; if a transaction has at least two of the five characteristics, disclosure is required.

The regulations also provide exceptions to the disclosure rule. The first factor includes transactions that were made "under conditions of confidentiality . . . ." Conditions of confidentiality include situations where "an offeree’s disclosure of the structure or tax aspects of the transaction is limited in any way by an express or implied understanding or agreement with or for the benefit of any tax shelter promoter . . . ." Also included are situations where there is no agreement, but the "tax shelter promoter knows or has reason to

171. See NYSBATS Comments, supra note 119, at 1478.
174. NYSBATS Comments, supra note 119, at 1478.
175. See id.
176. Stratton, supra note 134, at 1311.
know that the offeree's use or disclosure of information relating to the structure or tax aspects of the transaction is limited for the benefit of any person other than the offeree in any other manner . . . ."181

One problem with this factor is the type of information "the structure or tax aspects of the transaction" should cover.182 What if the confidential agreement only "restrict[s] . . . aspects of the transaction that have no relationship to . . . [United States] tax benefits?"183 It is not reasonable to label such an agreement as indicative of a tax shelter if the restriction has nothing to do with taxes.

The second factor covers transactions where the taxpayer has some form of contractual protection in the event the intended tax benefits are not realized by the taxpayer.184 The types of contractual protection covered by this factor may be in various forms, "including, but not limited to, rescission rights, [and] the right to a . . . refund of fees" from the promoter.185 The scope of this factor is overly broad. Protection may come in different forms, including the situation where a taxpayer, although not entitled to a refund of fees, has the right to shut down the transaction if the IRS successfully challenges it.186 It is unclear if such a "rescission right" is included under this factor.187

The third tax shelter characteristic covers transactions where the taxpayer pays more than $100,000 to a promoter for participation in the transaction.188 The flaw in this factor is that the $100,000 fee threshold is too easily met. Any special project or study performed by a reasonably sized accounting or law firm, such as a transfer pricing study, costs more than $100,000 in fees.

The next characteristic has the same problem: if there is a book tax difference in treatment by more than $5 million, then this factor is met.189 Too many transactions have large book tax differences, such

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181. Id.
182. NYSBATS Comments, supra note 119, at 1458.
183. Id.
185. Id.
186. See NYSBATS Comments, supra note 119, at 1461.
187. See id.
as inclusion of subpart F income,\textsuperscript{190} nondeductible goodwill,\textsuperscript{191} and employee stock options.\textsuperscript{192}

The final characteristic involves the participation of a person . . . [who] is in a Federal income tax position that differs from that of the taxpayer . . . and . . . such difference . . . has permitted the transaction to be structured . . . to provide the taxpayer with more favorable . . . tax treatment than it could have [otherwise] obtained . . . .\textsuperscript{193}

This is probably intended to cover transactions similar to the one used in \textit{ACM Partnership}.\textsuperscript{194} However, it is not clear what constitutes a different income tax position. For example, does it cover situations where “one party has recently realized a large capital gain and the other has net losses?”\textsuperscript{195} What about the difference in taxation between corporations and individuals?\textsuperscript{196}

There are also problems relating to the exceptions to disclosure. If the taxpayer’s participation is in the ordinary course of business and the taxpayer would have participated in the same transaction regardless of the expected tax benefits, then no disclosure is necessary.\textsuperscript{197} In addition, no disclosure is required if the participation is in the ordinary course of business and the tax benefits from the transaction have generally been allowed under the I.R.C.\textsuperscript{198} What should result if the transaction is partially related to the taxpayer’s business?

A transaction is also exempt from disclosure if “[t]he taxpayer reasonably determines that there is no reasonable basis . . . for denial of any significant portion of the expected Federal income tax benefits from the transaction.”\textsuperscript{199} This exception raises the same “no reasona-

\begin{footnotesize}
\textsuperscript{190} Subpart F income is tainted income derived by a foreign subsidiary that is a controlled foreign corporation (“CFC”). \textit{See Meldman \& Schadewald, supra} note 44, at 145. “The United States generally does not tax foreign business profits earned through a foreign subsidiary until the subsidiary distributes those earnings to the [United States] parent corporation as a dividend.” \textit{Id.} at 299. One of the most common types of tainted income is in the form of foreign based company sales income, where the CFC purchases or sells goods to a related person, and the goods are produced from outside the CFC’s country of incorporation and sold for use outside that country. \textit{See id.} at 145–46, 148.

\textsuperscript{191} \textit{See Lee A. Sheppard, Watering Down the Corporate Tax Shelter Regulations?}, 91 \textit{Tax Notes} 877, 878 (2001).

\textsuperscript{192} \textit{See NYSBATS Comments, supra} note 119, at 1462.


\textsuperscript{194} \textit{See discussion supra} Part I.B.1.a.

\textsuperscript{195} \textit{NYSBATS Comments, supra} note 119, at 1463.

\textsuperscript{196} \textit{See id.}


\textsuperscript{199} \textit{Temp. Treas. Reg.} § 1.6011-4T(b)(3)(ii)(C).
\end{footnotesize}
ble basis" issue found in the section 6111 Registration Rules. 200 If the standard for no reasonable basis is set very high, then this exception is essentially meaningless, because almost all transactions will be disclosed and "less inference would be drawn from any disclosure that was made." 201 If the standard is lower, practitioners may be more inclined to give the necessary opinion to fall within this exception.

A final exception to the disclosure requirement is available where the transaction has projected tax savings of $1 million or less in any year or $2 million or less for any combination of years if the IRS has already identified such transaction as a tax avoidance, or $5 million or less in any single year or $10 million or less in any combination of years in other situations. 202 In determining the projected tax savings, the regulation has listed several items that must be taken into consideration, as well as items that should not be taken into account, such as "gain on property that the taxpayer acquired independently of its participation in the transaction." 203 This rule does not make much sense. Under this exception, the transaction in ACM Partnership would be exempt from disclosure, because Colgate's capital gain in ACM Partnership was generated independently of the CINS plan purchased from Merrill that generated the capital losses used to offset that capital gain. 204 If Colgate does not take into consideration this capital gain, and does not project significant capital gains in the future, Colgate would not have much of a projected tax benefit from the CINS capital loss, as capital losses are only deductible to the extent of capital gains for corporate taxpayers. 205 It is unlikely Congress intended this result when it enacted this exception.

III. Solutions

The regulations are filled with problems of interpretation. In addition, "[i]t would be naïve [for the government] to think this is going to stop what's going on." 206 The best solution is to do away with the current regulations altogether. "The current proposals broadly pro-

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200. See discussion supra Part II.A.
204. See discussion supra Part I.B.1.a. See also NYSBATS Comments, supra note 119, at 1465.
205. See I.R.C. § 1211(a) (West 2000).
scribe so many powers to the government that there is a real likelihood that, if enacted in their current form, corporate taxpayers would be discouraged from considering any tax savings measures for fear of the costly and time-consuming litigation that would ensue.” Other methods of recognizing and stopping corporate tax shelters are available and should be implemented instead. The government should “allow corporations the tax benefits necessary to remain competitive in today’s global marketplace, while eliminating the most egregious abuses.”

A. Alternatives to the Regulations

One alternative method is to have corporate tax liability determined according to Generally Accepted Accounting Principles (“GAAP”). Under GAAP, most tax shelters would have no effect on tax liability. Since chief financial officers of large corporations generally wish to report as high a profit as possible, it is unlikely that they will want to take the tax shelter deduction on their books.

Another possible method is for the IRS to increase the number of audits it conducts in the corporate income tax area. Many taxpayers take questionable deductions on their income tax returns with the knowledge that the chances of being audited are slim. Increasing the number of audits will increase the IRS’s chances of catching these questionable deductions. “Loss-generating shelters will almost always fail in litigation . . . .” The IRS can always resort to the court system.

207. Casarona, supra note 62, at 140–41.
208. Id. at 141.
209. GAAP are “conventions, rules, and procedures that define approved accounting practices at a particular time. [They] are issued by the Financial Accounting Standards Board for use by accountants in preparing financial statements.” Black’s Law Dictionary 692 (7th ed. 1999). This proposed alternative is similar to Professor Yin’s suggestion of taxing public corporations on their income reported “for financial accounting purposes, as adjusted by tax rules authorizing specific deviations from a book income tax base.” George K. Yin, Getting Serious About Corporate Tax Shelters: Taking a Lesson From History, 54 SMU L. Rev. 209, 224 (2001). Professor Yin suggested application only to public companies, as non-public companies “have many opportunities unavailable to public corporations to reduce or eliminate their corporate income by paying out their earnings in tax-deductible ways.” Id. at 228. However, unlike Professor Yin’s suggestion, this proposed alternative is to apply to all subchapter C corporations, public as well as non-public. Such application will promote consistency of taxable income computations among subchapter C corporations. In addition, it eliminates the possibility of allowing large non-public corporations to take advantage of the tax shelters undetected.
210. See discussion supra introduction.
211. See discussion supra introduction.
212. Canellos, supra note 8, at 69.
when a taxpayer wishes to challenge any audit adjustments. If the odds of an IRS audit are greater, and if the IRS is willing to take more disputed cases to the courts, taxpayers may be less aggressive in taking these deductions and playing the audit lottery.

A third solution, which actually complements the previous method, is for the IRS to increase its audit expertise. Very often, business people take advantage of auditors who understand the general principles of accounting and tax but are unable to identify questionable transactions. Currently, "the pay and status accorded government auditors makes recruiting and retention difficult." However, if so much tax revenue is lost because of corporate tax shelters, providing higher pay and increasing the IRS's resources and expertise should be a relatively small investment compared to its potential returns.

A fourth alternative is simply to require a taxpayer to disclose details of each specific undertaking of fees paid to professional firms, such as legal, financial, and accounting fees. If the taxpayer has participated in a tax shelter and paid fees up front, a large dollar amount would appear in the details. If payment is over the course of several years, the consistent appearance of a particular project (or similar projects) over several years would be a good indicator of participation in a possible tax shelter transaction.

B. Proposed Changes to the Registration Rules

If doing away with the regulations is not a viable solution, certainly the language of the regulations should be revised and clarified, especially in light of recent Fifth Circuit and Eighth Circuit decisions in favor of taxpayers. Practitioners have already proposed changes to certain tests and thresholds imposed by the regulations. For example, the AICPA has suggested that instead of using the "no

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213. Such was the case in ACM P'ship, ASA Investerings P'ship, and Compaq Computer Corp. See discussion supra Part I.B.1.

214. Taxpayers playing the audit lottery are betting on not being selected for an audit examination by the IRS.

215. This statement does not imply that there are no qualified IRS auditors who understand the tax laws thoroughly and are capable of identifying questionable transactions.

216. Bankman, supra note 14, at 1786.

217. See discussion supra Part B.1.


219. See Boca Investerings P'ship v. United States, 167 F. Supp. 2d 298 (8th Cir. 2001); see also Sheppard, supra note 89 (critiquing the Boca decision).
reasonable basis” standard, a “realistic possibility of success” standard should be adopted instead.

The Treasury should clarify other terminology used in the regulations. Clarification of the term “important” is needed under the “important part of the intended results” criteria of the tax avoidance test. The regulation should provide a list of safe harbor transactions where registration is not required under this test.

Under the “no reasonable basis” exception, the Treasury should provide more guidance. The required standard necessary to meet this exception should be quantified. Since this standard is intended to be very high, a “more likely than not” standard would probably not be sufficient. Because it is highly unlikely that the IRS would allow 100% of the tax benefits from any particular transaction, perhaps a chance that four out of five auditors would approve the tax benefits is a better level of standard for this purpose. The $100,000 aggregate fees threshold should also be increased to a minimum of $500,000, since attorney and accountant fees for services have increased in general, and having a low aggregate fee threshold likely would cover too many routine consulting services.

C. Suggested List Rule Modifications

Section 6112 and the related regulations require organizers to keep a list of taxpayers who have purchased an interest in a tax shelter, and a de minimis exception is allowed when the taxpayer paid less than $25,000 total consideration. The AICPA has recommended that this fee threshold be increased to $1 million to avoid having to keep track of a large number of small transactions. The rationale behind AICPA’s fees threshold increase is commendable. However, because $1 million is a large increase from the $25,000 currently required by the regulations, the Treasury is unlikely to be willing to accept this proposal. Instead, a compromise of a $500,000 fees threshold, consistent with the recommended change to the fees threshold under Registration Rules, would be desirable. In addition, the regulation should specifically exclude listing taxpayers who have

221. See Sawyer, supra note 18, at 575.
225. See I.R.C. § 6112(a) (CCH 2000).
227. See Sawyer, supra note 18, at 573-74.
paid fees to promoters for information, but for whom the transactions were never carried out.

To resolve the issue of how detailed an explanation is required under the list requirement,228 the New York State Bar Association ("NYSBA") suggested the issuance of a Revenue Procedure to provide more guidance.229 This suggestion, by listing the required details in a Revenue Procedure, will certainly be a step closer to resolving the ambiguities of the requirements imposed by this regulation.

D. Revisions to the Disclosure Rules

In addition to the method of clarification proposed for the List Rules, the NYSBA has suggested several changes to the common tax shelter characteristics described under the Disclosure Rules.230 For the conditions of confidentiality factor,231 the NYSBA recommended coverage of "only . . . the features of the transaction that are necessary to an understanding of how the intended [United States] federal income tax benefits are to be derived."232 It also suggested that under the contractual protection factor, only a right to reimbursement or reduction in fees upon a successful IRS challenge be included.233

For the third tax shelter characteristic,234 an increase of the promoter fees requirement from $100,000 to $500,000 suggested by the NYSBA235 is in line with the changes proposed under the Registration and List Rules previously discussed. A consistent fees threshold throughout these tax shelter regulations should help exclude the small transactions and avoid inconsistencies between requirements imposed on the promoter and requirements imposed on the taxpayer. This way, the taxpayers and the promoters of the transactions will be required to report the same transactions and fee payments on their respective tax returns.

The Treasury should also modify the $5 million book tax difference factor.236 The regulation should include a list of certain regular book tax differences that are not taken into consideration for the pur-

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228. See discussion supra Part II.B.
229. See NYSBATS Comments, supra note 119, at 1479.
230. See id. at 1449.
232. NYSBATS Comments, supra note 119, at 1449.
233. See id.; see also discussion supra Part II.C.
234. See Temp. Treas. Reg. § 1.6011-4T(b)(3)(i)(C); see also discussion supra Part II.C.
235. See NYSBATS Comments, supra note 119, at 1449.
pose of this factor, such as timing differences\textsuperscript{237} and deductions for employee stock options. Otherwise, almost all large corporations will fall under this factor. As for the "participation of a person in a different tax position" characteristic,\textsuperscript{238} the regulation should include a list of illustrations of when a person is in a "different tax position" for the purposes of the regulation.

Under the no reasonable basis exception provided by the Disclosure Rules,\textsuperscript{239} the same changes for the Registration Rules previously discussed\textsuperscript{240} should be implemented. The regulation should specify an eighty percent standard to qualify under the no reasonable basis exception. For the projected tax effect test,\textsuperscript{241} the regulation should point out that capital gains acquired independently of the transaction will be taken into account if the transaction generates losses that would not otherwise be deductible but for that gain. This way, a transaction such as the one in ACM Partnership will clearly be covered under the regulation.

\section*{Conclusion}

The proliferation of corporate tax shelters is an issue that the government needs to address. However, the temporary and proposed regulations as they currently stand are not reasonable solutions to the problem. Alternatives should be considered and adopted. If alternative solutions are not implemented, at the very least, the regulations should be rewritten to provide clearer and more reasonable guidance.

\textsuperscript{237} There are many large book tax differences resulting from timing differences between GAAP rules and tax rules, such as deduction for vacation accrual and recognition of deferred income.
\textsuperscript{238} Temp. Treas. Reg. § 1.6011-4T(b)(3)(i)(E); \textit{see also} discussion \textit{supra} Part II.C.
\textsuperscript{240} See discussion \textit{supra} Part III.A.
\textsuperscript{241} See Temp. Treas. Reg. § 1.6011-4T(b)(4)(i); \textit{see also} discussion \textit{supra} Part II.C.