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No Joke: Circular 230 Is Here to Stay

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I. Introduction

In the wake of a new American Bar Association formal opinion covering tax shelters and a recently enacted suite of antishelter penalties in 1982, many observers believed that the Treasury Department would withdraw its proposed amendments to Circular 230 covering legal opinions used in the promotion of tax shelters. They were wrong. Treasury stayed the course. It issued modified proposed regulations in 1982 and final regulations in 1984. Throughout the process, Treasury absorbed input from the practitioner community. And it complemented Congress’s continued efforts to curb tax shelter activity with additional rounds of new and strengthened statutory penalties. By the mid-1980s, the Treasury Department and Circular 230 had become the catalyzing force of a coordinated and aggressive antishelter effort.

II. Modified Circular 230 Amendments

On December 15, 1982, Treasury issued modified proposed amendments to Circular 230.1 The modifications responded to widespread outcry from the organized bar, the tax bar, and the practitioner community over Treasury’s promulgation of proposed changes to Circular 230 two years earlier.2 According to Treasury, over that period it had received 90 written comments to the proposed amendments from attorneys, CPAs, enrolled agents, the organized bar, accounting organizations, taxpayers, and special interest groups.3 In November 1980, moreover, 15 persons testified at a public hearing on the proposed rules, offering comments and criticism.4 Treasury received 30 additional correspondences after it invited public comment on the establishment of an advisory committee to assist it in administering the proposed new standards for regulating tax shelter opinions.5

The modified regulations closely paralleled ABA Formal Opinion 346,6 with slight modifications. Issued 11 months earlier, Opinion 346 addressed “many of the fundamental concerns” of Treasury for tax shelter opinions and appeared “generally to contain adequate standards for meeting those concerns.”7 Treasury was particularly pleased that Opinion 346 required opinion writers to state whether the aggregate benefits of a shelter were likely to be realized, thereby effectively prohibiting “reasonable basis” opinions (which had allowed lawyers to issue opinions subsequently used in the promotion of tax shelter investments that never offered a prediction on the outcome in the likely event of litigation). “Accordingly,” Treasury said, “the proposed regulation has been substantially modified in order to reflect the principles and ethical considerations delineated in ABA Opinion 346.”8 Treasury’s proposed rules were still justified, because of the “variation in enforcement” of the multiple professional licensing authorities.9 Circular 230 would provide “uniform, direct action” for regulating the conduct of tax professionals.10

A. Treasury’s General Antishelter Philosophy

Before describing specific modifications to the original proposal, Treasury enunciated its general philosophy for tax shelter opinions and the regulation of tax advisers.

First, Treasury would not budge on negative opinions. Those opinions often stated that aggregate material tax benefits in an offering were not likely to be allowable if

1Modified Proposed Regulations, Tax Shelters; Practice Before the Internal Revenue Service, 47 Fed. Reg. 56144 (Dec. 15, 1982), at Supplementary Information.
3Practice Before the Internal Revenue Service; Request for Public Comments on Establishing an Advisory Committee on Opinions by Practitioners Before the Internal Revenue Service Used in the Promotion of Tax Shelters, 45 Fed. Reg. 79835 (Nov. 17, 1980).
4ABA Committee on Ethics and Professional Responsibility, Formal Opinion 346 (rev.) (Jan. 29, 1982).
5Modified Proposed Regulations, supra note 1, at Supplementary Information.
6Id.
7Id.
8Id.
9Id.
10Id.
litigated, but there was still a reasonable basis for the reporting position. Opinion 346 did not prohibit tax lawyers from writing those opinions. But Treasury believed that tax practitioners "should not actively encourage potential tax shelter investors to pursue conduct which the practitioner believes is contrary to the tax laws." A negative opinion, under those circumstances, obviously cast doubt on the investor's reasonable belief in the position and made it difficult to avoid the propriety. A negative opinion, under those circumstances, obviously cast doubt on the investor's reasonable belief in the position and made it difficult to avoid the section 6661 penalty. For those reasons, the modified Circular 230 proposal did not prohibit negative opinions. Nonetheless, Treasury warned practitioners that it viewed negative opinions unfavorably, and reserved the right to reconsider the issue if those opinions continued to proliferate notwithstanding section 6661. 

The modified proposed amendments to Circular 230 also responded to practitioner concerns that the new rules threatened the attorney-client relationship. The proposed rule, Treasury explained, did not affect or regulate the tax lawyer's relation with individual clients. Rather, it applied exclusively to tax shelter opinions. To avoid the penalty, an investor had to show "substantial authority" for his reporting position. Opinion 346 did not prohibit tax shelter opinions, but rather, it applied exclusively to tax shelter opinions, and conflicted with due diligence requirements under federal securities laws. In the modified proposal, Treasury responded by adopting due diligence guidelines that closely resembled those of Opinion 346, which, in turn, incorporated the guidelines of Formal Opinion 335, dealing specifically with assumed facts opinions in connection with the sale of unregistered securities. Those guidelines recommended that a lawyer "should make adequate preparation including inquiry into the relevant facts," and "not accept as true that which he should not reasonably believe to be true." But they did not require a lawyer to "audit" the affairs of his client or to assume, without reasonable cause, "that a client's statement of the facts cannot be relied upon." To the standards of Opinion 335 and Opinion 346, Treasury added the requirement that practitioners inquire as to the fair market value of property in two situations: first, when the value was material to the potential tax benefits of the transaction, and second, when the value was determined by appraisal. Treasury also addressed due diligence standards regarding critical tax issues. The original proposal required practitioners to draw legal conclusions for each material

with enforcing regulations under Circular 230, administered a set of rules that were independent of the IRS — the agency that prosecuted tax disputes against individual taxpayers — and provided administrative due process safeguards in addition to judicial review. And finally, the Treasury Department enjoyed independent statutory authority to discipline incompetent and unethical conduct by practitioners. 

B. Treasury's Specific Circular 230 Modifications

Treasury also articulated a specific antishelter strategy. In so doing, it addressed several practitioner concerns with the original proposal.

The original amendments imposed overly burdensome due diligence standards, according to tax practitioners. On factual matters, practitioners had expressed anxiety that the original amendments required them to guarantee or audit all relevant facts, prohibited practitioners from relying on the opinions of clients and third-party experts even if that reliance was fully disclosed, and conflicted with due diligence requirements under federal securities laws. In the modified proposal, Treasury responded by adopting due diligence guidelines that closely resembled those of Opinion 346, which, in turn, incorporated the guidelines of Formal Opinion 335, dealing specifically with assumed facts opinions in connection with the sale of unregistered securities. Those guidelines recommended that a lawyer "should make adequate preparation including inquiry into the relevant facts," and "not accept as true that which he should not reasonably believe to be true." But they did not require a lawyer to "audit" the affairs of his client or to assume, without reasonable cause, "that a client's statement of the facts cannot be relied upon." To the standards of Opinion 335 and Opinion 346, Treasury added the requirement that practitioners inquire as to the fair market value of property in two situations: first, when the value was material to the potential tax benefits of the transaction, and second, when the value was determined by appraisal. Treasury also addressed due diligence standards regarding critical tax issues. The original proposal required practitioners to draw legal conclusions for each material

11Id. For a discussion of Treasury's authority as well as the administrative due process safeguards and judicial review under Circular 230, see Ventry, supra note 2, at 1148.
12ABA Committee on Ethics and Professional Responsibility, Formal Opinion 335 (Feb. 2, 1974).
13Id.
14Id.
15For a discussion of old section 6661 and TEFRA, see Dennis J. Ventry Jr., "ABA Formal Opinion 346 and a New Statutory Penalty Regime," Tax Notes, June 12, 2006, p. 1269, at 1273-1275.
16Modified Proposed Regulations, supra note 1, at Supplementary Information.
17Id. (Emphasis in original.)
tax issue in a tax shelter offering. There were no exceptions. Moreover, the legal opinion had to predict the chance of success if challenged for each material tax issue, and not merely claim a reasonable basis for a particular position. The modified rule paralleled Opinion 346. It required practitioners to “fully and fairly” address all material tax issues. But it only required them to opine “where possible” about the “likely outcome” of each material tax issue. Also, Treasury noted that to avoid understatement penalties under new section 6661, investors had to “reasonably believe” that the treatment of a tax item on a return is “more likely than not” the proper treatment. Only “in the exceptional case” did the modified rule permit practitioners to withhold judgment about the likely outcome of an issue. In those rare instances, the practitioner was required to include a statement of his inconclusive position with sufficient supporting reasons.

Some of the most vehement practitioner criticism of the original proposal was leveled at the more likely than not standard. Thus, Treasury spent a good deal of time addressing those concerns. Practitioners had expressed particular anxiety with the vagueness and subjectivity of the requirement that opinions reach a more likely than not conclusion about the “bulk” of the tax benefits. In the modified proposal, “bulk of the tax benefits” became “the material tax benefits in the aggregate.” And “in the aggregate,” like “bulk” before it, remained “substantially more than 51%.” Also like the original amendments, the modified proposal did not offer further explanation or clarifying examples for “substantially more than 51%.”

Treasury offered a spirited defense of the requirement that practitioners provide an overall evaluation of the likely outcome of aggregate tax benefits in the event of litigation. Invoking Opinion 346, Treasury argued that “good tax practice” required practitioners to opine on whether the aggregate tax benefits “are likely to be realized as contemplated by the offering materials.” Treasury also reiterated its steadfast opposition to negative opinions, arguing that those opinions fell below standards of good tax practice and amounted to disreputable conduct subject to discipline. Treasury was less opposed to reliance opinions and limited scope opinions, but subjected them to restrictions. The modified proposal clarified that a practitioner could rely on the legal opinions of other practitioners, provided he carefully review the work and satisfy himself that it independently met the requirements under Circular 230. For limited scope opinions, if another practitioner provided the overall evaluation, the practitioner rendering a partial opinion had to examine the overall determination and have no reason to believe that it was incorrect or false.

Treasury also addressed several definitional issues. It responded to practitioner anxieties that the definition of tax shelter was too broad, it captured proper as well as abusive transactions, overburdened practitioners with divining the intent of anonymous investors, and lacked a list of exempt transactions. Treasury’s modified definition adopted that of the ABA’s in Opinion 346, which significantly narrowed the number of affected transactions, removed requirements for gleaning investor intent, and included an angel list. Treasury also conformed its definition of material tax issue to the ABA’s with minor modifications requiring practitioners to consider potentially negative tax consequences, including penalties and interest. For “tax shelter opinions,” the Treasury definition also followed that of Opinion 346, but emphasized that such an opinion did not include advice rendered solely to a client-promoter as long as the advice was not used in connection with sales promotion efforts.

Tax practitioners had also expressed fear that the new rules would be used in a draconian fashion to discipline wayward practitioners. Treasury addressed the original proposal’s omission of “willfulness” as a requirement for violating the proposed regulations. The modified rule stopped short of including a willfulness requirement as requested by practitioners, because such a requirement would “make it impossible to discipline the negligent or incompetent practitioner, a possibility Treasury wishes to retain.” But the Treasury Department recognized that it had to offer guidance on how it would enforce the rule. To that end, it adopted the disciplinary approach under Opinion 346 and the ABA Code of Professional Responsibility. Generally, that approach prohibited knowing or reckless conduct (sufficient for recovery by investors under Rule 10b-5) as well as conduct involving gross negligence (that is, gross incompetence, indifference to consequences, inadequate preparation under the circumstances, and consistent failure to perform obligations to the client). To that approach, Treasury added conduct determined to be part of a pattern of failures to comply with the proposed rules.

Before concluding, Treasury specified what was only implied in the original proposal: Disciplinary action could be taken against firms for the misconduct of individual firm members. Section 10.52(c) stated that Treasury could undertake disciplinary proceedings against a firm “if the tax opinion is a firm opinion and if there is an unreasonable absence of procedures within the firm to review firm opinions.” Treasury explained “unreasonable absence of procedures” as a pattern of opinions attributable to members of the firm or the firm....

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22Id. at section 10.33(a)(3).
23Id. at section 10.33(a)(4).
24Section 6111(b)(2)(C)(ii).
25Modified Proposed Regulations, supra note 1, at Supplementary Information. Treasury believed that because the standards under Circular 230 required only a prediction as to outcome and not a guaranteed outcome, those occasions would be rare indeed when a practitioner could not make a final judgment.
26Id. at section 10.33(a)(5).
27Id. at Supplementary Information.
28Id.
29Id. at sections 10.33(b)(1) and (2).
itself that the firm knew or reasonably should have known violated Circular 230.

Finally, the modified proposed amendments added new section 10.76, authorizing the director of practice to establish an advisory committee to assist in determining when a practitioner or his firm was in violation of Circular 230. The establishment of the committee followed the recommendation of the ABA for a “peer review system” to assist in disciplinary actions under the new rule.36

III. Reaction to Treasury’s Modified Proposal

The organized bar and tax practitioners responded positively to the modified proposed amendments. Some observers attributed the upbeat response to practitioners’ preoccupation with the recently enacted statutory penalties under TEFRA, particularly the substantial understatement penalty.37 Whatever the reason, the modified Circular 230 regulations were met with broad practitioner support.

The ABA Section on Taxation “warmly supported the revised proposal, particularly insofar as it adopts the principles stated in Formal Opinion 346.”38 Although the modified amendments differed slightly from Opinion 346, the ABA Tax Section felt that the revised proposal, in combination with the recently enacted substantial understatement penalty, “should adequately deal with abusive tax shelter opinions.”39 Moreover, by conforming revisions to the standards enunciated in Opinion 346, Treasury arguably embraced the notion that primary responsibility for promulgating and enforcing ethical and disciplinary rules for tax practitioners “should rest with the professional associations whose members engage in that practice.”40

While largely pleased with the modified proposed amendments, the ABA Tax Section offered several suggestions.

First, the ABA reiterated its concern about the lack of a willfulness requirement under section 10.52(b). Moreover, it objected to the “gross negligence” standard for disbarment and offered as a substitute the “more familiar concept” of “gross incompetence.”41

Second, for definitional issues, the ABA Tax Section praised Treasury for conforming its tax shelter definition to that of Opinion 346, and for improving on the definition of material tax issue, which as written in Opinion 346 contained an “unintended flaw” whereby such items as the characterization of income as ordinary income or capital gain and the availability of a depletion allowance were unintentionally excluded.

Third, the ABA Tax Section noted favorably that the revised proposed amendments required an opinion on the merits of each material tax issue only “where possible.” But it urged Treasury to conform Circular 230 standards to those of Opinion 346 and to require opinions only when there was a reasonable possibility of IRS challenge.

Fourth, according to the ABA Tax Section, there “does not appear to be any reason” why the revised proposed amendments should not adopt a “where-possible standard” for overall evaluations concerning whether material tax benefits were likely to be realized. Treasury had adopted such a standard, after all, for opinions on the merits of each material tax issue. It was “unnecessary and undesirable to permit this divergence between the revised proposal and Formal Opinion 346.”

Fifth, the standards for reliance opinions under Circular 230 should similarly align with Opinion 346. The revised Treasury proposal required lawyers providing partial opinions to verify the accuracy of the work of a practitioner furnishing the overall opinion, while Opinion 346 merely required the lawyer to satisfy himself that the overall opinion undertook the requisite overall evaluation.

Sixth, the ABA Tax Section praised Treasury for adopting its recommendation for an advisory panel made up of tax practitioners.

And finally, the ABA Tax Section sharply criticized Treasury’s attempt to expand its disciplinary oversight to firms whose individual members violated Circular 230 rules.

The Association of the Bar of the City of New York (NYCB) offered similar, albeit more qualified, praise for the revised proposal. An NYCB special committee on Circular 230 commended Treasury for adopting a “sound approach” and for “tracking the guidelines” of Opinion 346.42 The organization also praised Treasury — although in a mischaracterization — for “accept[ing] the view” that a practitioner “may give a negative opinion in a tax shelter offering.”43 Notwithstanding the kudos, the NYCB focused criticism on Treasury’s proposed enforcement procedures and the provisions related to violations of new Circular 230 rules.

In a series of professionally self-interested recommendations, the NYCB expressed opposition to Treasury’s attempt to regulate the behavior of tax attorneys.

The director of practice, charged with enforcing Circular 230 ethical and disciplinary standards, was not a

37See “Gideon Discusses Substantial Understatement Penalty,” Tax Notes, Feb. 7, 1983, p. 560 (stating that the substantial understatement penalty had “clearly replaced Circular 230 as the focus of concern among tax professionals”).
38ABA Section of Taxation, “Statement on Revision to Proposed Rule Amending Circular 230 with Respect to Tax Shelter Opinions,” 36 Tax Law. 861 (Summer 1983).
40Id. See also ABA Section of Taxation, supra note 38, at 861.
41ABA Section of Taxation, supra note 38. Remaining citations in the following paragraphs are from id.
42Special Committee on the Lawyer’s Role in Tax Practice, Association of the Bar of the City of New York, “The Lawyer’s Role in Tax Practice,” 36 Tax Law. 865 (Summer 1983). Remaining citations in the paragraph are from id.
43Recall that the revised amendments did not explicitly prohibit the issuance of negative opinions because recently enacted section 6661 effectively prohibited the issuance of those opinions. See supra, at “Treasury’s General Antishelter Philosophy.”
disinterested party. As such, he should be prohibited from appointing members to the proposed advisory committee charged with reviewing and making recommendations for alleged violations of the new rules. Moreover, according to the NYCB, the advisory committee would be authorized to act “only upon recommendation of the committee.” The NYCB further assumed that practitioners would be offered adequate opportunity to be heard by the committee. “Several members” of the NYCB’s special committee insisted that practitioners charged with violating Circular 230 regulations receive a de novo court trial before being suspended or disbarred. The NYCB declared that Treasury should be authorized only to suspend or disbar practitioners who rendered flatly false opinions or who engaged in a pattern of issuing incompetent opinions. Furthermore, Treasury was not authorized to impose entity liability on law firms. “Practitioners before the Internal Revenue Service must be individuals,” the NYCB opined; “there is no concept of practice by a firm.”

Ultimately, the NYCB doubted that ethical rules, promulgated either by Treasury or professional organizations, would curb aggressive reporting positions. Tax standards should be established by Congress. In the end, tax compliance would improve only through statutory penalties aimed at taxpayers, not ethical or disciplinary guidelines aimed at practitioners.

* * *

Treasury indicated that it was not prepared to shrink from the task of regulating the tax shelter marketplace. Then-IRS Commissioner Roscoe Egger announced that in the event Circular 230 did not discourage tax practitioners from writing opinion letters for abusive tax shelter offerings, the IRS could seek help from state securities agencies and the ABA. Much work remained to be done. Egger reported in late 1983 that despite Opinion 346, tax shelter activity continued unabated. Moreover, Diane Grant of the IRS tax shelter program reported that most tax lawyers accepted uncritically appraisals from tax shelter promoters, a practice that violated Circular 230 rules. And Fran Schaefer of the IRS Office of Chief Counsel said practitioners simply used “the magic language of 346” to meet the requirements superficially, while the tax shelter transactions proceeded unabated. By itself, Opinion 346 could not curb abusive tax shelter activity. Rather, it would take the combined effort of the organized bar, the Treasury Department, and Congress to sufficiently attack the tax shelter problem.

IV. 1984 Final Circular 230 Regulations

The amendments to Circular 230 were finalized in February 1984. The final rule, like the revised proposal, followed the general guidelines of Opinion 346. Treasury also made several changes “of a clarifying and stylistic nature.”

Finalizing rather than withdrawing the proposed rule, as some commentators had suggested, was justified for several reasons. The publication of Opinion 346 indicated that the organized bar recognized that tax lawyers owed special ethical obligations when rendering tax shelter opinions. Treasury viewed that recognition as strengthening its own belief that tax practitioners must meet specific threshold standards of conduct when giving tax shelter opinions and that practitioners falling below that threshold should be disciplined. Moreover, finalizing the proposed rule was justified because Treasury had independent statutory authority to discipline incompetent and unethical behavior by practitioners while the ABA did not. There was no guarantee that state bar associations would enforce standards of practice under Opinion 346. But Treasury could enforce uniform regulatory standards, which, at any rate, closely paralleled those of the organized bar. Finally, the new Circular 230 rules reinforced the penalty regime enacted under TEFRA. Also, the final regulations complemented ongoing congressional efforts to regulate tax shelter activity, including efforts in 1984 that would become part of that year’s Deficit Reduction Act (see infra, at “DEFRA’s Antishelter Provisions”).

The final rule made only modest changes to the revised proposal, most of which reflected practitioner concerns discussed above.

First, the final regulations clarified the practitioner’s responsibility to verify facts associated with a tax shelter transaction by moving from the supplementary information to the rule’s text a statement outlining appropriate due diligence standards.

Second, for rendering an opinion on each material tax issue, the final rule said that such an opinion was necessary only for material issues involving a reasonable IRS challenge.

Third, the final rule required that practitioners render overall evaluations only “where possible” and that unfavorable overall evaluations, or opinions concluding that an overall evaluation is not possible, must be clearly disclosed in the offering materials. Treasury also provided four relatively unhelpful examples to illustrate the principles embodied in the requirement that practitioners give an overall evaluation when “substantially more than half” the material tax benefits more likely than not would

44 All citations in this paragraph are from the special committee, NYCB, supra note 42.
46 Some practitioners urged Treasury to take an even tougher stance against tax shelter activity. Tax lawyer Dick Brennan, for one, recommended that Treasury discipline attorneys for providing misleading negative opinions, require attorneys to treat penalties as “material” items in every opinion, and provide that attorneys inquire whether appraisals of property “make sense.” Never mind that the proposed Circular 230 amendments already required those things. It was notable enough that tax lawyers were on board with Treasury’s newly asserted role. See supra, at section 10.33(a)(1).
47 Id. at Supplementary Information.
49 "Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries Before the Internal Revenue Service, 49 Fed. Reg. 6719 (Feb. 23, 1984)."
50 Id. at section 10.33(a)(3).
51 Id. at section 10.33(a)(5).
be realized.\textsuperscript{52} One of the examples, for instance, indicated that 70 percent qualified as “substantially more than half.” But what about 65 percent? Or 55 percent? Practitioners were left guessing.

Fourth, practitioners were permitted to render limited scope opinions, provided they had “no reason” to doubt another practitioner’s overall evaluation, a requirement that was met by reviewing the overall evaluation to determine if it made sense “on its face.”\textsuperscript{53}

Fifth, the final rule reintroduced a motivational element to the tax shelter definition, but only to avoid retroactive reclassification of an investment as a tax shelter if unintended losses exceeded income in any year.\textsuperscript{54}

And sixth, the final rule deleted the earlier proposal permitting Treasury to discipline an entire firm for opinions written by individual firm members that violated the tax shelter standards contained in Circular 230.\textsuperscript{55}

After nearly four years, substantial practitioner input, one significant revision, additional practitioner participation, and a sea of commentary, Circular 230 regulations governing the role of IRS practitioners in the tax shelter marketplace were finalized. While some observers continued to object to Treasury’s meddling,\textsuperscript{56} the overwhelming majority of the tax practitioner community accepted — perhaps reluctantly — Treasury’s ethical and disciplinary guidelines.

V. DEFRA’s Antishelter Provisions

Treasury’s antishelter efforts were bolstered by Congress’s continued commitment to end abusive tax shelter schemes. Only five months after Treasury finalized Circular 230 regulations, Congress passed the Deficit Reduction Act of 1984 (DEFRA).\textsuperscript{57} The new law added several antishelter provisions to the IRC, while strengthening several existing provisions.\textsuperscript{58}

The new registration and list maintenance requirements were by far the most important additions to the ongoing tax shelter battle.

Under section 6111, tax shelter organizers and promoters were required to register certain tax shelter investments with the IRS.\textsuperscript{59} The organizer was expected to file Form 8264 by the first day an interest in the tax shelter was offered for sale. Form 8264 prompted the organizer to describe the investment, its tax benefits, the tax shelter ratio (the ratio of deductions and credits to the total investment), the accounting method used, and the source of financing. If the principal organizer failed to register the shelter, responsibility for registration fell to any person participating in the organization, sale, or management of the shelter investment. “Participation” generally did not include professional advice rendered by lawyers or accountants as long as professional fees did not reflect the number of units sold, in which case the lawyer or accountant could be treated as sharing in the entrepreneurial risk of the transaction. The IRS issued identification numbers to all properly registered shelters. Shelter investors, in turn, were required under section 6707 to include the relevant shelter identification number(s) on new Form 8271 and to file the form as part of their regular tax returns.\textsuperscript{60} Failure to register the shelter investment resulted in a penalty of $500 or 1 percent of the aggregate amount invested in the shelter, whichever was greater. The penalty could be waived if failure to register was due to reasonable cause. Organizers also faced a penalty of $100 for each failure to provide investors with a tax shelter identification number. And investors faced a penalty of $250 for failing to include the number on their tax return.

DEFRA added additional provisions to the antishelter lexicon that, although enacted to combat individual tax shelters, became integral components of the modern battle against corporate tax shelters.

Section 6112 required organizers and promoters of “potentially abusive tax shelters” to maintain investor lists.\textsuperscript{61} The list maintenance requirement applied to all registered shelters as well as any “other plan or arrangement which is of a type which the Secretary determines by regulations as having a potential for tax avoidance or evasion.”\textsuperscript{62} Section 6112 also required organizers to make

\textsuperscript{52}Id. at section 10.33(a)(5)(iv). For a good discussion of the examples, see Falik, supra note 21.

\textsuperscript{53}Id. at section 10.33(b)(1). According to some observers, the requirements for partial opinions forced the practitioner “to follow a rather perilous course. Because he has not been retained to provide an overall evaluation, the client would anticipate that his fee would be proportionately less than that of the practitioner rendering the overall evaluation. The practitioner rendering the partial opinion, however, is now held to a level of responsibility requiring him to carefully review the other practitioner’s opinion and analysis,” thus adding “an additional layer of expense to the client’s undertaking.” Falik, supra note 21.

\textsuperscript{54}Id. at Supplementary Information. The final regulations defined tax shelter as “an investment which has as a significant and intended feature for Federal income or excise tax purposes either of the following attributes: (i) Deductions in excess of income from the investment being available in any year to reduce income from other sources in that year; or (ii) credits in excess of the tax attributable to the income from the investment being available in any year to offset taxes on income from other sources in that year.” Id. at section 10.33(c)(2). Emphasis added.

\textsuperscript{55}Id.

\textsuperscript{56}Falik, for one, complained that Circular 230, in combination with new statutory penalties, “may be instruments for inflicting anxiety and uncertainty that severely undermines the potency of the accountant’s certificate and the lawyer’s opinion.” Falik, supra note 21.

\textsuperscript{57}P.L. 98-369 (July 18, 1984).


\textsuperscript{59}Added by section 141(a) of P.L. 98-369.

\textsuperscript{60}Added by section 141(b) of P.L. 98-369.

\textsuperscript{61}Added by section 142(a) of P.L. 98-369.

\textsuperscript{62}Section 6112(b)(2).
the lists available to the IRS on request, and to retain the
lists for seven years. New section 6708 imposed a penalty
for failure to maintain investor lists as required under
section 6112.63 Organizers were subject to a $50 penalty
for each failure, up to an annual maximum of $50,000.

The 1984 legislation contained other miscellaneous en-
forcement provisions. DEFRA strengthened section 6700,
the penalty on tax shelter promoters, first enacted in
1982.64 The size of the penalty was increased from 10
percent to 20 percent of the income to be derived from
promoting abusive tax shelters, with a minimum penalty
of $1,000. The 1984 law also toughened section 7408, the
1982 provision that permitted the IRS to enjoin promoters
of abusive tax shelters for violating section 6700.65 DEFRA
broadened the injunctive power to include violations oc-
curring under section 6701 for aiding and abetting the
understatement of tax. Finally, DEFRA increased interest
on tax deficiencies for underpayments tied to “tax moti-
vated transactions,”66 and it amended section 6601(e)(2)
so that interest on some penalties would run from the due
date of a return rather than from the billing date.67

VI. Conclusion

By the end of 1984, Treasury had gotten what it
wanted in only four short years: a series of new statutory
penalties intended to change the incentive structure of
the tax shelter marketplace; stricter standards for tax
practitioners engaged in tax shelter activity enforceable
with the threat of suspension or disbarment; and mean-
eningful action from professional organizations motivated
by the fear of abdicating involuntarily their historical
right of self-regulation. Moreover, as 1984 gave way to
1985, the ABA was preparing to issue a formal opinion
reevaluating the much-maligned reasonable basis stan-
dard. While Opinion 346 had confined itself to ethical
and disciplinary standards for lawyers rendering opinions
on tax shelter investments to third parties, the
forthcoming opinion promised to encompass all other
aspects of tax practice, including tax controversy repre-
sentation and tax reporting advice. By all accounts, it
seemed as if a coordinated effort against tax shelters —
involving Treasury, Congress, and tax practitioners —
had solidified.

In the next installment of Policy and Practice: Lowering
the Ethical Bar: ABA Formal Opinion 85-352.

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63 Added by section 142(b) of P.L. 98-369.
64 Amended by section 143(a) of P.L. 98-369.
65 Amended by section 143(b) of P.L. 98-369.
66 Amended by section 144(a) of P.L. 98-369. The new penalty
was 120 percent of the regular rate for underpayments more
than $1,000 attributable to valuation overstatements of 150
percent or higher, disallowance of loss deductions or investment
tax credits due to violation of the at-risk rules, tax straddles, use
of accounting methods resulting in a substantial distortion of
income, sham or fraudulent transactions, and other “tax moti-
vated” transactions as defined by the regulations.

67 P.L. 98-369, sections 158(a), 211(b)(26), 412(b)(7), and
714(n)(1). The interest computation applied to failures to file
returns under code section 6651(a)(1), gross valuation under-
statements under section 6659, valuation understatements for
estate or gift tax purposes under section 6660, and substantial
understatements of tax under section 6661.