

OVERCOMING OVERDISCLOSURE: TOWARD TAX SHELTER DETECTION

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Every year, thousands of taxpayers and their advisors are required to mail special disclosure forms that reveal details of potentially abusive tax strategies to the Office of Tax Shelter Analysis of the Internal Revenue Service in Ogden, Utah. This mandatory disclosure regime has been widely praised as one of the government's most effective weapons in its war on tax shelters. In contrast to this largely positive portrayal, however, this Article argues that the current tax shelter disclosure law is incomplete. While the primary aim of current law is to deter nondisclosure of information by taxpayers and advisors, my claim is that the government should also strive to prevent behavior that may be just as problematic to the IRS's ability to detect and challenge tax shelters—overdisclosure of information. As this Article demonstrates, since the introduction of the tax shelter reporting rules in 2000, taxpayers and advisors have frequently disclosed to the IRS their participation in routine, nonabusive transactions or details of activities that are irrelevant to tax shelter detection. After investigating the sources of overdisclosure, I conclude that the tax law itself invites this response from distinct types of taxpayers and advisors. Conservative types overdisclose out of excessive caution, while aggressive types overdisclose in an attempt to avoid detection of abusive tax planning. As a result of the threats to tax administration posed by overdisclosure, I offer three novel proposals for proactively reducing its occurrence: the introduction of anticipatory angel lists when the IRS designates new listed transactions; the enactment of targeted overdisclosure penalties; and a non-tax documentation requirement for business taxpayers.

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INTRODUCTION

At the foot of the Wasatch Mountains about ten miles east of the Great Salt Lake, the Internal Revenue Service searches for tax shelters. Inside its vast processing facility in Ogden, Utah, officials in the IRS Office of Tax Shelter Analysis sort through thousands of disclosure statements from taxpayers and their lawyers, accountants, and other advisors that provide details of complex transactions that IRS officials suspect might be abusive.¹ Because tax shelters at first may appear to comply with the literal text of the Internal Revenue Code and resemble real business deals, they often fail to raise red flags for the IRS on their own.² In response to this detection obstacle, the tax law mandates that taxpayers and their advisors disclose to the IRS instances in which they participate in a myriad of transactions that bear tax shelter traits.³

Commentators have praised the tax shelter reporting rules as a “powerful tax enforcement tool” that leads to “enhanced compliance.”⁴ Some former top government officials have even boldly declared that as a result of these rules, “the tax shelter war is over” and “[t]he government won.”⁵ When the mandatory disclosure regime works well, it provides the IRS with a valuable audit roadmap, enabling it to detect abusive tax planning that would otherwise remain hidden. Mandatory disclosure can provide taxpayers and their advisors with early warnings of the tax positions that the IRS will challenge. The reporting rules also chill the market for tax strategies that must be disclosed to the IRS.⁶

1. Taxpayers are required to disclose the details of reportable transactions in which they participate by filing IRS Form 8886, Reportable Transaction Disclosure Statement, with the IRS Office of Tax Shelter Analysis in Ogden, Utah. Treas. Reg. § 1.6011-4 (d) (as amended in 2007). Tax advisors that qualify as material advisors are required to file IRS Form 8918, which bears similar information. Treas. Reg. § 301.6111-3(d)(1) (2007).

2. See Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 VA. TAX REV. 339, 363–68 (2005); Joshua D. Blank, *What's Wrong With Shaming Corporate Tax Abuse*, 62 TAX L. REV. (forthcoming 2009) (manuscript at 7–10, available at <http://ssrn.com/abstract=1365888>) (discussing the rules/standards distinction in tax shelter context).

3. Taxpayers and their advisors are required to report their participation in arrangements the IRS has identified as listed transactions, those it considers potentially abusive, such as the Son of BOSS or Sale In/Lease Out arrangements. Treas. Reg. § 1.6011-4(b)(2); see, e.g., Rev. Rul. 2002-69, 2002-2 C.B. 760 (Lease In/Lease Out transactions); I.R.S. Notice 2000-44, 2000-2 C.B. 255 (Son of BOSS transactions). The rules also require taxpayers and their advisors to inform the IRS if they have pursued transactions possessing much more general features. Treas. Reg. §§ 1.6011-4(b)(3), (4).

4. Ronald A. Pearlman, *Demystifying Disclosure: First Steps*, 55 TAX L. REV. 289, 323 (2002).

5. Pamela Olson, *Now That You've Caught the Bus, What Are You Going to Do With It? Observations From the Frontlines, the Sidelines, and Between the Lines, So to Speak*, 60 TAX LAW. 567, 567 (2006).

6. See *infra* notes 54–65 and accompanying text for discussion.

In contrast to this largely positive portrayal, this Article argues that the current tax shelter disclosure law is incomplete. While the primary aim of current law is to deter nondisclosure of information by taxpayers and advisors, my claim is that the government should also strive to prevent behavior that is just as problematic to the IRS's ability to detect and challenge tax shelters—overdisclosure of information. As this Article demonstrates, since the introduction of the tax shelter reporting rules in 2000, taxpayers and advisors have frequently disclosed to the IRS their participation in routine, nonabusive transactions or details of activities that are irrelevant to tax shelter detection. After investigating the sources of overdisclosure, I conclude that the tax law itself invites this response from distinct types of taxpayers and advisors. Conservative types overdisclose out of excessive caution, while aggressive types overdisclose in an attempt to avoid detection of abusive tax planning. Other scholars have acknowledged the hypothetical potential for overdisclosure in response to the mandatory tax shelter disclosure regime,⁷ but none have thoroughly addressed why overdisclosure may occur or whether or how it may be avoided. This Article thus provides the first rigorous investigation of the sources of overdisclosure in the context of tax shelter reporting and offers strategies, absent from current law, for preventing the overdisclosure response.

The overdisclosure response poses serious threats to tax administration. When the IRS receives disclosure statements regarding complex transactions that lack tax avoidance motivation, its agents must investigate and distinguish these transactions from those that actually are abusive. This distraction slows the IRS's investigations of truly abusive transactions, delaying statutory responses to tax avoidance strategies. Further, the substantial time that taxpayers and their advisors spend preparing and filing unnecessary disclosure statements represents wasteful behavior.⁸

Overdisclosure is a natural reaction from conservative, cautious taxpayers and advisors. The categories of transactions that taxpayers and advisors must disclose are broad: The IRS requires disclosure not only of specifically described transactions,⁹ but also involvement in any arrangements that may result in “similar” tax consequences or involve “similar” fact patterns.¹⁰ The IRS has often been slow to explain how the tax shelter reporting rules should

7. See *infra* note 67 and accompanying text.

8. See LARGE & MID-SIZE BUS. SUBGROUP, INTERNAL REVENUE SERV. ADVISORY COUNCIL, PUBLIC MEETING BRIEFING BOOK 11–12 (2006), available at http://www.irs.gov/pub/irs-utl/2006_irsac_public_meeting.pdf (discussing overdisclosure problem); Dustin Stamper & Sheryl Stratton, *Guidance Coming on New Shelter Rules, Says Treasury Official*, 105 TAX NOTES 785, 785 (2004).

9. Treas. Reg. § 1.6011-4(b)(2) (as amended in 2007) (requiring taxpayers to disclose listed transactions).

10. Treas. Reg. § 1.6011-4(c)(4).

be applied in uncertain situations. Because the penalties for failing to comply with the mandatory disclosure regime are severe, and apply on a strict liability basis,¹¹ the breadth of current law causes conservative taxpayers and advisors to provide more rather than less information when in doubt.¹²

For aggressive taxpayers and advisors—those that push the envelope by claiming the riskiest tax positions—overdisclosure provides an attractive strategy for avoiding IRS detection of abusive tax planning. By reporting a multitude of nonabusive transactions along with their most questionable tax positions, aggressive taxpayers and advisors may believe that they will escape high penalties for nondisclosure without increasing the likelihood that the IRS will detect and challenge their abusive transactions.¹³ Further, aggressive taxpayers and advisors may be emboldened by the tax law's explicit endorsement of their behavior.¹⁴ Finally, after hearing frequent public statements by IRS officials that the Service has received too much information in response to some of its disclosure requests,¹⁵ aggressive types may seize on the overdisclosure strategy as a way to avoid IRS detection.

How can overdisclosure be overcome? I propose three novel changes to the substantive tax law that could enable the government to address the overdisclosure response proactively.

First, the IRS should revisit its approach to designating tax strategies as listed transactions, the types of tax strategies that the government considers to be most blatantly at odds with Congress's intent.¹⁶ Under the current regime, tax strategies that the IRS does not intend to cover are noticeably absent from the IRS's announcements of new listed transactions.¹⁷ In contrast, I propose that before designating a tax strategy as a listed transaction, IRS officials should endeavor to compile a list of clearly nonabusive transactions that the most scrupulous conservative taxpayers and advisors might find substantially similar to it. Under the proposal, when the IRS designates a strategy as a listed transaction, it would include in its announcement an

11. See, e.g., I.R.C. § 6707A(b)(2) (B) (2006) (setting forth a fixed monetary penalty of \$200,000 for corporations failing to disclose a listed transaction).

12. See Jeremiah Coder, *Official Explains Changes in Final Transaction Reporting Regs*, 116 TAX NOTES 925, 925 (2007) (quoting a senior Treasury Department official as stating "taxpayers have erred on the side of caution by narrowly construing ['substantially similar']").

13. See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968); Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 COLUM. L. REV. 569 (2006) (discussing expected value analysis).

14. Treas. Reg. § 1.6011-4(c)(4) (key reporting requirements must be "broadly construed in favor of disclosure.").

15. See *infra* Part III.C.3.

16. See Treas. Reg. § 1.6011-4(b)(2) for the definition of a listed transaction.

17. See *infra* notes 235–239 and accompanying text.

anticipatory angel list of some of these nonabusive transactions, exempting them from mandatory disclosure.

Next, taxpayers and advisors that overdisclose should face targeted monetary penalties. While current federal tax law contains high monetary and nonmonetary penalties for taxpayers and advisors that fail to file required disclosure statements, it contains no explicit penalties for those that, either out of caution or malice, file unnecessary statements.¹⁸ As opposed to the status quo, my proposal would impose a monetary penalty upon any taxpayer or advisor that discloses a transaction included on an angel list. My proposal would however exempt from this penalty any taxpayer or advisor that had sought and received a private letter ruling from the IRS permitting disclosure of the transaction at issue. The proposed overdisclosure penalty would supplement, not replace, the nondisclosure penalties under current law.

Last, the IRS should reconsider the type of information it requires taxpayers to provide in their disclosure statements. As this Article illustrates, the current disclosure model relies heavily on the taxpayer's written description of a transaction, a description that can be lengthy and complex.¹⁹ In contrast to this model, I suggest that the IRS require corporate and partnership taxpayers to provide certain non-tax documentation, such as written descriptions of disclosed transactions that the taxpayers prepared for actors other than the IRS, such as chief executive officers, boards of directors, shareholders, or partners. This approach, I argue, would better enable the IRS to sort abusive transactions from nonabusive ones and could discourage taxpayers from filing unnecessary disclosure statements.

The remainder of this Article is presented as follows: Part I discusses how the IRS currently searches for tax shelters. Part II offers specific examples of the overdisclosure response. Part III investigates the overdisclosure incentives under current law for conservative taxpayers and advisors, on the one hand, and aggressive taxpayers and advisors, on the other. Finally, Part IV offers and elaborates on the three aforementioned proposals for addressing and limiting the overdisclosure response.

18. See *infra* notes 259–260 and accompanying text.

19. See INTERNAL REVENUE SERV., EXAMINATION GUIDE—ABUSIVE TAX SHELTERS AND TRANSACTIONS, pt. III.A.1, at 2–6 (2003), available at http://ftp.irs.gov/pub/irs-utl/iii.a._sources_to_identify_shelters.pdf (describing role of reportable transaction statement in IRS audits).

I. THE SEARCH FOR TAX SHELTERS

A. The Elusive Nature of Tax Shelters

An abusive tax shelter is a tax strategy that produces amazing tax benefits that Congress never envisioned, but that seem to flow, at least on a strict constructionist reading, from the text of the Internal Revenue Code. At first glance, tax shelters resemble legitimate business deals that ought to receive the tax treatment claimed. As prominent tax lawyer Peter Canellos once commented, “tax shelters bear a relationship to real transactions analogous to the relationship between money laundering and banking.”²⁰ The close resemblance between a real business deal and a tax shelter is what makes the IRS’s task of detecting abusive tax planning so difficult.

Consider, for example, the following stylized version of a popular tax shelter strategy that was widely used by America’s most well-known corporations in the late 1990s:²¹

In 1999, Blue Chip Co., a large Fortune 500 corporation, sold stock of one of its portfolio investment companies in the open market and earned a \$50 million profit on the sale. This was wonderful news to the managers of Blue Chip Co., except for one pesky detail—the \$50 million gain was subject to the federal corporate income tax.²²

Tax Director, who was responsible for Blue Chip Co.’s tax planning and compliance, quickly arranged a meeting with Accountant. After Tax Director signed a confidentiality agreement, Accountant described how Blue Chip Co.’s \$50 million taxable gain could vanish if Blue Chip Co. engaged in a series of transaction steps otherwise known as the “contingent liability” tax strategy. Upon Accountant’s advice, Blue Chip Co. incorporated a new subsidiary corporation (Sub), contributed \$51 million cash plus \$50 million worth of healthcare claims that were outstanding against Blue Chip Co. to Sub, and then, days later, sold the stock of Sub to a trust created by Blue Chip Co. for

20. Peter C. Canellos, *A Tax Practitioner’s Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. REV. 47, 52 (2001).

21. See *Black & Decker Corp. v. United States*, 436 F.3d 431 (4th Cir. 2006). For thorough discussion of this transaction, see Karen C. Burke, *Black & Decker’s Contingent Liability Shelter: ‘A Thing of Grace and Beauty’?*, 106 TAX NOTES 577 (2005) and Ethan Yale, *Reexamining Black & Decker’s Contingent Liability Tax Shelter*, 108 TAX NOTES 223 (2005). See also STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., REPORT OF INVESTIGATION OF ENRON CORPORATION AND RELATED ENTITIES REGARDING FEDERAL TAX AND COMPENSATION ISSUES, AND POLICY RECOMMENDATIONS 109–35 (Comm. Print 2003) (outlining “Project Tanya” and “Project Valor,” contingent liability tax shelters that Enron utilized in the late 1990s).

22. Assuming a 35 percent tax rate, this taxable gain would result in a \$17.5 million tax liability for Blue Chip Co.

its fair market value, \$1 million, in cash.²³ Accountant guaranteed Tax Director that these steps would allow Blue Chip Co. to claim a tax loss that—like magic—would cause Blue Chip Co.’s \$50 million taxable gain to disappear. So sure was Accountant of the validity of this tax position that he promised to refund his own \$1 million fee if the IRS successfully challenged the tax position.²⁴

When Tax Director filed Blue Chip Co.’s 1999 annual tax return with the IRS, he did not report the contingent liability transaction described above or any of his dealings with Accountant. Nor did Tax Director reveal the technical interpretation of the tax law that enabled Blue Chip Co. to claim a \$50 million tax loss on the sale of the Sub stock for \$1 million.²⁵ And Tax Director certainly did not disclose that Blue Chip Co. did not actually lose \$50 million in this transaction.

Not until the IRS audited the tax return of Blue Chip Co. several years later did its agents uncover the facts surrounding the transaction. In the audit, IRS agents questioned Tax Director about Blue Chip Co.’s sale of the Sub stock and requested all documentation related to the transaction. The IRS determined that the principal purpose of Accountant’s transaction was for Blue Chip Co. to enjoy a valuable tax benefit. As the IRS and, later, the courts would determine,²⁶ the contingent liability transaction was an abusive tax shelter, a transaction that lacked “economic substance” and was inconsistent with Congress’s intent.

But by the time the IRS understood the true nature of Blue Chip Co.’s transaction, hundreds of other taxpayers had met with Accountant and also

23. The fair market value of the Sub stock was \$1 million because it held \$51 million of assets (cash) and \$50 million of liabilities.

24. The fee of tax shelter promoters is often based on a percentage of the tax savings a particular product generates. When Enron engaged in contingent liability tax shelters Project Tanya and Project Valor, it paid its advisor, Arthur Anderson, \$500,000 and \$100,000, respectively. STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., *supra* note 21, at 123, 127; *see also* David Cay Johnston, *Sham Shelters for Businesses Flourish as Scrutiny Fades*, N.Y. TIMES, Dec. 19, 2000, at A1 (describing fee structure of tax shelter promoters).

25. The tax theory was that Blue Chip Co.’s contribution of the \$51 million of cash and \$50 million of liabilities would qualify as a tax-free transaction because, in exchange, Blue Chip Co. would receive sufficient stock in Sub to control Sub immediately after the contribution. *See* I.R.C. § 351 (2006). Blue Chip Co.’s tax basis in its newly received Sub stock would normally equal the value of the cash contributed reduced by any liabilities assumed by Sub. *See* I.R.C. § 358(a)(1) (2006). However, under the tax law at the time of this transaction, Blue Chip Co. argued that it was not required to reduce its basis in the Sub stock because the liabilities were the type that would “give rise to a deduction” in the hands of Blue Chip Co. I.R.C. § 357(c)(3) (2006). Thus, Blue Chip Co. assumed a \$51 million tax basis in its Sub stock and when it received \$1 million on the sale of this stock, it claimed a \$50 million capital loss for tax purposes.

26. *See Black & Decker Corp.*, 436 F.3d 431; *Coltec Indus., Inc. v. United States*, 454 F.3d 1340 (Fed. Cir. 2006), *cert. denied*, 127 S. Ct. 1261 (2007); I.R.S. Notice 2001-17, 2001-1 C.B. 730.

pursued the contingent liability transaction to claim large tax losses.²⁷ What made this particular tax strategy so popular was that, precisely as Accountant had suggested, it appeared to be “perfectly legal,”²⁸ fitting squarely within the technical language of the tax law.²⁹ No specific statutory rule, at that time, prevented Blue Chip Co. from claiming its tax loss.³⁰

B. Red Flag Requirements

The widespread use of tax shelters like the contingent liability strategy imposes social costs. When taxpayers engage in abusive tax planning, the government loses revenue. Congress may then respond by increasing the tax rates that apply to other taxpayers.³¹ From an economic perspective, tax shelter planning is wasteful because individuals dedicate effort to exploiting ambiguities in the tax law rather than producing anything of value apart from tax savings.³² And frequent newspaper stories of tax shelter activity may decrease overall taxpaying morale and, in turn, tax compliance, as taxpayers who do not use shelters feel like “chumps” for paying more taxes than necessary.³³

Without help from taxpayers and the individuals who advise them, the IRS would face significant obstacles in detecting tax strategies like the contingent liability transaction discussed above. Current law, consequently, imposes an obligation on taxpayers and their advisors to raise red flags for the IRS when they participate in transactions that bear tax shelter traits.³⁴

The law requires taxpayers to file a disclosure statement with the IRS Office of Tax Shelter Analysis at its processing facility in Ogden, Utah, if they have participated in any “reportable transaction” during the taxable year.³⁵ Agents in this office review filings by taxpayers and advisors and determine whether a particular tax avoidance strategy merits attention from high-level IRS officials.³⁶

27. See, e.g., Richard M. Lipton, *New Tax Shelter Decisions Present Further Problems for the IRS*, 102 J. TAX'N 211, 211–17 (2005).

28. See DAVID CAY JOHNSTON, *PERFECTLY LEGAL: THE COVERT CAMPAIGN TO RIG OUR TAX SYSTEM TO BENEFIT THE SUPER RICH—AND CHEAT EVERYBODY ELSE* (2003).

29. See *supra* note 25.

30. After the IRS learned of the contingent liability tax shelter, Congress enacted a targeted statutory fix that prevented its further use. See I.R.C. § 358(h).

31. See David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 221–22 (2002).

32. See *id.* at 222–23.

33. See Blank, *supra* note 2, at 47–48 (discussing reciprocity theory and tax compliance).

34. See Treas. Reg. § 1.6011-4 (as amended in 2007) (taxpayer disclosure requirements); see also Treas. Reg. § 301.6111-3(d)(1) (2007) (material advisor disclosure requirements).

35. See Sheryl Stratton, *Inside OTSA: A Bird's-Eye View of Shelter Central at the IRS*, 100 TAX NOTES 1246, 1246–47 (2003). Taxpayers are also required to attach the disclosure statement to their annual tax returns. Treas. Reg. § 1.6011-4(e).

36. See Stratton, *supra* note 35, at 1247.

The following transactions are reportable transactions under the tax shelter disclosure rules:

Listed Transactions. The most specific type of tax strategy that taxpayers must disclose to the IRS is a “listed transaction.”³⁷ A tax strategy is only a listed transaction if the government explicitly describes it as such. Colorfully named strategies that the major accounting firms marketed to taxpayers in the late 1990s like COBRA (currency options bring reward alternatives)³⁸ and PICO (personal income company),³⁹ as well as the contingent liability transaction,⁴⁰ occupy this list. These are the strategies that the government considers to be most clearly at odds with congressional intent. In many cases, courts have confirmed the IRS’s view.⁴¹ Taxpayers must disclose to the IRS any participation in a listed transaction or “substantially similar” transaction.⁴²

The “substantial similarity” standard enables the IRS to receive necessary information about certain abusive tax strategies. Without this requirement, taxpayers and advisors could easily avoid any disclosure obligation by tweaking a potentially abusive tax strategy to distinguish it from the listed transactions.

Transactions of Interest. Taxpayers must also report their participation in any strategy that the IRS describes as a “transaction of interest” or any substantially similar transaction.⁴³ This category is designed to give the IRS flexibility to investigate arrangements “for which the IRS and Treasury Department lack enough information to determine whether [they] should be identified specifically as tax avoidance transaction[s].”⁴⁴

Confidential Transactions and Transactions with Contractual Protection. Tax shelter promoters may attempt to protect their tax shelter strategies from spreading too quickly by forbidding taxpayers who buy them from revealing the details to anyone else.⁴⁵ In addition, to entice buyers, tax shelter promoters may promise taxpayers refunds of their fees if the IRS rejects the strategies

37. Treas. Reg. § 1.6011-4(b)(2). The IRS maintains the list of abusive tax shelters on its website. See Internal Revenue Service, *Abusive Tax Shelters and Transactions*, <http://www.irs.gov/businesses/corporations/article/0,,id=97384,00.html> (last visited June 9, 2009).

38. I.R.S. Notice 2002-35, 2002-1 C.B. 992.

39. I.R.S. Notice 2002-65, 2002-2 C.B. 690.

40. I.R.S. Notice 2001-17, 2001-1 C.B. 730.

41. See, e.g., *Black & Decker Corp. v. United States*, 436 F.3d 431 (4th Cir. 2006).

42. Treas. Reg. § 1.6011-4(c)(4).

43. Treas. Reg. § 1.6011-4(b)(6).

44. T.D. 9350, 2007-38 I.R.B. 607.

45. See U.S. DEP’T OF TREASURY, *THE PROBLEM OF CORPORATE TAX SHELTERS: DISCUSSION, ANALYSIS AND LEGISLATIVE PROPOSALS* (1999); Joseph Bankman, *The New Market in Corporate Tax Shelters*, 83 TAX NOTES 1775, 1780 (1999) (discussing tax shelter promoters’ use of confidentiality restrictions).

on audit.⁴⁶ As a result, the law requires taxpayers to disclose transactions where they have rights to refunds of fees if promised tax consequences do not materialize or where a highly paid advisor limits their ability to describe the details of tax advice to others.⁴⁷

Loss Transactions. Many tax shelters seek to shift taxable income to a tax-exempt party, enable the use of tax credits, or generate a tax-deductible loss. For this reason, the last category of reportable transactions requires taxpayers to disclose “loss transactions,” which consist of certain sales or exchanges of stock, assets, and other property that lead taxpayers to claim large losses for tax purposes (\$10 million in the case of corporations and \$2 million in the case of individuals).⁴⁸

The disclosure requirements described above apply not only to the taxpayers that engage in reportable transactions, but also to the lawyers, accountants, and others who advise them. If an advisor recommends a reportable transaction in exchange for a minimum fee⁴⁹ and the taxpayer actually pursues the transaction, the advisor is characterized by the law as a “material advisor.”⁵⁰ Every material advisor must file a disclosure statement with the Office of Tax Shelter Analysis describing the reportable transactions they have recommended in exchange for a minimum fee.⁵¹ In addition, every material advisor must maintain a list of the taxpayers that have caused her to be characterized as a material advisor.⁵² The IRS may request this list at any time.⁵³

46. See U.S. DEP'T OF THE TREASURY, *supra* note 45, at 24 (discussing promoters' refund arrangements).

47. Treas. Reg. §§ 1.6011-4(b)(3), (4). As Leandra Lederman has commented more generally, the IRS should consider contact between a third-party tax shelter promoter and taxpayer regarding such a “tax-advantaged” strategy as “a red flag suggesting that the transaction—and similar transactions engaged in by other taxpayers—warrants closer scrutiny to determine its substantive content.” Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 738–39 (2007).

48. Treas. Reg. § 1.6011-4(b)(5). In addition to these categories, the Treasury has recently proposed adding patented tax strategies to the list of reportable transactions. Prop. Treas. Reg. § 1.6011-4(b)(7), 72 Fed. Reg. 54615, 54617 (Sept. 26, 2007).

49. The minimum fee in cases involving listed transactions and transactions of interest is \$10,000 where the advisee is an individual and \$25,000 where the advisee is a corporation. Treas. Reg. § 301.6111-3(b)(3)(i)(B) (2007). In all other cases, the minimum fee is \$50,000 where the advisee is an individual and \$250,000 where the advisee is a corporation. *Id.* § 301.6111-3(b)(3)(i)(A).

50. *Id.* § 301.6111-3(b)(1).

51. *Id.* §§ 301.6111-3(d)(1), (e).

52. *Id.* § 301.6112-1(a) (as amended in 2007).

53. *Id.* § 301.6112-1(e). In addition to the tax shelter disclosure rules, certain corporate taxpayers are subject to disclosure regimes that require them to explain aspects of their financial accounting statements. Large corporate taxpayers file Schedule M-3 with the IRS, a form that requires them to reconcile inconsistencies between income they report for income tax and financial accounting purposes. I.R.S. Form 1120, Schedule M-3 (2008), available at <http://www.irs.gov/pub/irs-pdf/f1120sm3.pdf>. The Financial Accounting Standards Board has also recently taken steps to

C. The Appeal of Mandatory Disclosure

Government officials and academics have widely praised the disclosure approach as an effective response to the tax shelter problem.⁵⁴ They have argued that mandatory disclosure rules fortified by monetary penalties aid the audit process, chill participation in abusive tax strategies, and serve as an early warning system for lawmakers. Each of these justifications for the mandatory disclosure regime is discussed below.

Audit Roadmap. If taxpayers and their advisors were not obligated to provide some clues to the IRS, the field agents who initially review taxpayers' returns would have a difficult time detecting questionable tax positions.

Sophisticated tax shelter strategies often appear to comply with the letter of the tax law and certainly do not take the form of tax-protestor type arguments.⁵⁵ In the example of Blue Chip Co.'s contingent liability tax shelter, all that would have appeared to the naked eye of an IRS agent reviewing Blue Chip Co.'s tax return would be a \$50 million tax-deductible loss on Schedule D of IRS Form 1120,⁵⁶ along with many other capital gains and losses resulting from Blue Chip Co.'s sales of stock, bonds, and real estate during the year.

In addition, some taxpayers, especially corporations and partnerships, file tax returns that are simply enormous. General Electric Corp.'s 2006 annual tax return and accompanying schedules, for instance, were the equivalent of over 24,000 pages.⁵⁷ Further, many individual and business taxpayers are still

require corporations to highlight tax positions they view as uncertain. See FIN. ACCOUNTING STANDARDS BD., FASB INTERPRETATION NO. 48: ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES 1-7 (2006), available at <http://www.fasb.org/pdf/fin%2048.pdf>. Because the new financial accounting rules have only been in effect since 2006, their ability to "allow users of the financial statements to make judgments about management's [tax] risk appetite" is unclear. Brett Cohen & Reto Micheluzzi, *Lifting the Fog: Accounting for Uncertainty in Income Taxes*, 113 TAX NOTES 233, 234 (2006).

54. See *supra* notes 4-5 and accompanying text. Some academics, such as David Weisbach, have criticized the current tax shelter disclosure rules as a poor alternative to the introduction of a strong anti-abuse doctrine as a response to the tax shelter problem. David A. Weisbach, *The Failure of Disclosure as an Approach to Shelters*, 54 SMU L. REV. 73, 73-74 (2001). But even Weisbach concedes that the use of tax shelter disclosure as a means of detection "will do no harm." *Id.* at 73.

55. See U.S. DEP'T OF TREASURY, *supra* note 45, at 6 ("[Tax shelters] typically rely on one or more discontinuities of the tax law.").

56. Corporate taxpayers are required to report their gains and losses from the sales of capital assets on Schedule D of IRS Form 1120. See I.R.S. Form 1120, Schedule D (2008), available at <http://www.irs.gov/pub/irs-pdf/f1120sd.pdf>.

57. Press Release, Internal Revenue Serv., IRS E-file Moves Forward; Successfully Executes Electronic Filing of Nation's Largest Tax Return (May 31, 2006), available at <http://www.irs.gov/newsroom/article/0,,id=157845,00.html>.

permitted to file their tax returns on paper, rather than in electronic form.⁵⁸ The massive amount of information in some tax returns, coupled with the limited audit resources of the IRS, presents serious challenges to detection.

Mandatory disclosure is thus designed to provide an important “audit roadmap” to the IRS.⁵⁹ For example, as mentioned, under current law a taxpayer is now required to alert the IRS if the taxpayer uses a tax strategy sold by a tax shelter promoter who promised a money-back guarantee in the event of an audit.⁶⁰ The required disclosure statement may lead the IRS agent who initially reviews this tax return to select it for audit and quickly issue an information document request to the taxpayer.⁶¹ This enables the IRS to collect pertinent information regarding the transaction, which may result in a successful challenge of the tax benefits claimed.

Early Communication. The mandatory disclosure regime also serves an important communication function. The IRS typically releases a public announcement or notice when it designates a tax strategy as a listed transaction or transaction of interest.⁶² These announcements describe the mechanical details of the scheme at issue, so that taxpayers and advisors know what to disclose. The IRS also uses these announcements to present its reasoning for why the underlying tax strategy is inconsistent with congressional intent or would fail in court under the economic substance, business purpose, or other judicial doctrine. The IRS can issue such notices quickly, without waiting for public comment or congressional approval.⁶³ The need for frequent public guidance in a mandatory disclosure regime thus provides a quick-and-dirty way for the IRS to express its early condemnation of abusive tax strategies before their use spreads.

Chilling Effects. Finally, mandatory disclosure may deter taxpayers and advisors from pursuing tax strategies that are, or that may become, reportable transactions in the future. When the IRS announces that a tax strategy is potentially abusive and, in turn, subjects it to mandatory disclosure requirements, use of that strategy ceases. As the New York State Bar Association

58. A corporation that files fewer than 250 returns (including information returns) in a given year is not required to file electronically. Treas. Reg. §§ 301.6011-5 (a)(1), (d)(5) (2007).

59. See Pearlman, *supra* note 4, at 294–98 (suggesting audit efficiency as one of the prime rationales for enhanced tax shelter disclosure).

60. Treas. Reg. § 1.6011-4(b)(4) (as amended in 2007).

61. See INTERNAL REVENUE SERV., *supra* note 19, pt. III.A.1, at 6.

62. For a list of these public announcements, see Internal Revenue Service, Tax Information for Corporations, <http://www.irs.gov/businesses/corporations> (last visited Apr. 21, 2009).

63. For a discussion of the procedure the IRS uses to issue notices, see TAX SECTION, N.Y. STATE BAR ASS'N, REPORT NO. 1126, REPORT ON PROPOSED REGULATIONS AMENDING THE REPORTABLE TRANSACTION DISCLOSURE AND LIST MAINTENANCE RULES 6 (2007), available at <http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1126rpt.pdf>.

Tax Section has noted, “listed transactions have acquired a type of stigma. Many taxpayers have a written policy against engaging in any listed transaction and it appears that some malpractice insurers want to know whether their insureds provide advice with respect to listed transactions.”⁶⁴ Instead of pursuing tax strategies that the IRS has already designated as listed transactions or transactions of interest, most sophisticated taxpayers prefer to exploit gaps in the tax law that have yet to appear on the IRS’s radar screen.⁶⁵

II. THE OVERDISCLOSURE RESPONSE

Despite the appeal of mandatory disclosure as a way to bolster the IRS’s ability to detect and challenge abuse, this approach is subject to a serious vulnerability: Taxpayers and their advisors may provide too much information to the IRS. If taxpayers and advisors disclose information about transactions that are complex yet clearly not abusive, or transaction details that do not reveal underlying abuse, the mandatory disclosure regime fails to accomplish one of its principal purposes: helping the IRS find tax shelters. In the words of one IRS official, “if the default approach becomes disclosing every transaction, ‘the system is not going to work.’”⁶⁶

While commentators in the past have occasionally discussed the risk of overdisclosure in hypothetical terms,⁶⁷ the IRS’s experience since implementing the mandatory disclosure regime in 2000 confirms that the overdisclosure problem is more than mere academic conjecture. The number of disclosure statements submitted to the IRS appears to have increased dramatically in recent years. In 2007, an official at the IRS Office of Tax Shelter Analysis stated that the number of reportable transaction disclosure statements received by his office since 2004 had increased by over 7,300 percent and

64. *Id.* at 7 n.11.

65. See Marvin A. Chirelstein & Lawrence A. Zelenak, *Tax Shelters and the Search for a Silver Bullet*, 105 COLUM. L. REV. 1939, 1950 (2005) (“[T]he government cannot win this game”).

66. Crystal Tandon, *Too Many Unlisted Transactions Being Reported, IRS Officials Say*, 113 TAX NOTES 203, 203 (2006) (quoting Christopher B. Sterner, IRS division counsel, Large and Midsize Business Division).

67. See James S. Eustice, *Abusive Corporate Tax Shelters: Old “Brine” in New Bottles*, 55 TAX L. REV. 135, 151 n.194 (2002) (hypothesizing that “the Service may well be overwhelmed with ‘overdisclosures,’ in which case the regulations [will be] unlikely to have a meaningful impact”); Daniel Shaviro, *Disclosure and Civil Penalty Rules in the U.S. Legal Response to Corporate Tax Shelters*, 3 (N.Y. Univ. Sch. of Law & Econ. Research Paper Series Working Paper No. 07-05, 2007), available at <http://ssrn.com/abstract=955354> (theorizing that mandatory disclosure rules may be “compromised by taxpayer over-disclosure”).

that “maintaining the right number of disclosures and making sure they were all appropriate was a challenge.”⁶⁸

Data available from state taxing authorities strongly implies, however, that the IRS has experienced a much greater increase in the submission of reportable transaction disclosure statements. Several states require taxpayers that file reportable transaction disclosure statements with the IRS to file a similar, if not the same, statement with the state taxing authority.⁶⁹ For the 2005 and 2006 tax years, the New York State Department of Taxation and Finance announced that it received over 28,000 reportable transaction disclosure statements from individual and corporate taxpayers.⁷⁰ Because New York requires taxpayers to file a copy of the very same reportable transaction disclosure statement that they filed with the IRS, this figure reveals the number of statements that the IRS Office of Tax Shelter Analysis most likely received just from taxpayers in a single state over a two-year period. It is especially striking considering that prior to 2004, the number of disclosure statements that the IRS received from taxpayers and advisors on a nationwide basis each year often numbered in the hundreds, not thousands.⁷¹

A. What Is Overdisclosure?

Even the most ardent supporters of the mandatory disclosure regime concede that there are limits to its value. Dennis Ventry, for instance, has written that “[o]f course there is such a thing as too much disclosure, where the government cannot process the information or the taxpayer is overburdened by the requirements.”⁷² The question, then, is how much and what type of information is too much?

If the IRS operated with an unlimited budget and bench of specialized experts, there would be no harm in the submission of disclosure statements or accompanying materials that do not have a reasonable chance of exposing tax

68. Sam Young, *Officials Provide Update on Status of Tax Shelter Guidance*, 115 TAX NOTES 707, 707 (2007) (quoting an IRS Office of Tax Shelter Analysis official).

69. For instance, under legislation enacted in 2005, New York has mandated “every taxpayer required to file a reportable or listed transaction disclosure statement with the Internal Revenue Service, to attach a duplicate disclosure statement to the New York tax return.” N.Y. STATE DEPT OF TAXATION AND FIN., TAX SHELTER REPORTING 1 (2007), available at http://www.tax.state.ny.us/pdf/stats/policy_special/tax_shelter_reporting/tax_shelter_reporting.pdf.

70. *Id.* at 2.

71. In 2001, for example, the IRS received an aggregate of 86 reportable transaction disclosure statements on a nationwide basis. LARGE & MID-SIZE BUS., INTERNAL REVENUE SERV., ABUSIVE CORPORATE TAX SHELTERS BACKGROUND PAPER 3 (2001), available at <http://www.irs.gov/pub/irs-utl/abbakppr.pdf>.

72. Dennis J. Ventry, Jr., *Cooperative Tax Regulation*, 41 CONN. L. REV. 431, 477 (2008).

shelters. The IRS would simply discard that information and focus instead on disclosure statements that may reveal the details of potentially abusive tax strategies.

Unfortunately, this characterization of the tax shelter landscape is far from realistic, as the IRS operates with both a limited budget and limited staff.

The IRS's limited funds⁷³ have, in recent years, forced field agents of the IRS's Large and Midsize Business Division to reduce the length of audits of large corporate and other business taxpayers.⁷⁴ In fiscal year 2007, for example, the IRS's audit rates of the largest corporate taxpayers dropped to its lowest level since the late 1980s.⁷⁵

And despite the IRS's description of the Office of Tax Shelter Analysis as a sophisticated command-and-control center capable of reviewing thousands of taxpayer and advisor disclosure statements,⁷⁶ its staff, according to public reports, is of surprisingly modest size.⁷⁷ Describing the challenges that this unit faces at a U.S. Senate hearing in 2003, Calvin Johnson colorfully testified, "I doubt their total annual budget would cover the annual Holiday Parties for the Skunk Works factories they are competing against."⁷⁸

In light of these constraints on the IRS, when taxpayers disclose information that is not relevant to the detection of abusive tax planning, the mandatory disclosure regime may have the opposite of its intended effect. As a Treasury Department official once described the problem, "Overdisclosure transactions are the transactions that don't have the potential for abuse. They not only place a burden on taxpayers, but also place a burden on the Service."⁷⁹ Instead of helping field agents detect known abusive strategies, or even better, discover new strategies the IRS is not yet aware of, excessive disclosure statements may distract the IRS and consume valuable audit resources.

73. See Jeremiah Coder, *Tax Shelter Penalties Are Unclear and Weakly Enforced*, Panelists Say, 120 TAX NOTES 383, 385 (2008) (quoting an IRS official as stating that "the audit level has been 'cut to the bone'").

74. See Transactional Records Access Clearinghouse, *Audits of Largest Corporations Slide to All Time Low*, <http://trac.syr.edu/tracirs/newfindings/v13> (last visited June 9, 2009).

75. See *id.* at fig.1 (illustrating the decline in IRS audit rates of corporations with assets of \$250 million or more from 64 percent in 1988 to 26 percent in 2007).

76. See I.R.S. Announcement 2000-12, 2000-1 CB 835 (describing Office of Tax Shelter Analysis as "centralized point for the review of tax shelter transactions").

77. Sheryl Stratton, *supra* note 35, at 1246 ("For all it has to do, OTSA is surprisingly sparsely staffed—it has seven program analysts, one manager, and no attorneys.").

78. *U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals: Hearings Before the Permanent Subcomm. on Investigations of the S. Comm. on Governmental Affairs*, 108th Cong. 296 (2004) (statement of Calvin H. Johnson, Professor, University of Texas at Austin School of Law).

79. Stamper & Stratton, *supra* note 8, at 785 (quoting Jonathan Ackerman, Attorney-Advisor with Treasury's Office of Tax Policy).

But exactly what type of information constitutes overdisclosure?

Imagine that a corporation files a disclosure statement with the IRS and also attaches its last ten annual reports, consisting of hundreds of pages, which are required to be filed with the U.S. Securities and Exchange Commission. Some of this information, such as lengthy descriptions of officer biographies and current industry trends, concerns “transactions that don’t have the potential for abuse.”⁸⁰

IRS agents reviewing this submission would likely discard the annual reports as irrelevant and instead focus on the written discussion from the taxpayer. Surely overdisclosure cannot encompass all information that fails to reveal potentially abusive tax strategies.

Overdisclosure, rather, must not only fail to reveal potential abuse, but also must consume enough attention of IRS agents to “place a burden on the Service.”⁸¹ As opposed to hundreds of pages of publicly available annual reports, the type of disclosure statements that burden the Service are those describing highly complex transactions, which not only likely comply with a technical reading of the tax law, but also the underlying intent of Congress. The difference between this type of disclosure and the information described above is that the IRS cannot easily discard this type as irrelevant to tax shelter detection.

The most comprehensive definition, then, is that overdisclosure is the submission of information that (1) fails to report participation in a potential tax shelter, and that (2) the IRS cannot easily identify as failing to report participation in a potential tax shelter.

B. Examples of Overdisclosure

Overdisclosure can occur in a variety of ways. This Subpart offers concrete examples of the types of overdisclosure that the IRS has received from taxpayers and their advisors since the introduction of the mandatory tax shelter reporting regime in 2000.

1. Nonabusive Reportable Transactions

As IRS officials have complained, when the IRS issues rulings that require taxpayers to disclose participation in specific abusive tax strategies, the Service frequently receives many disclosure statements regarding uncontroversial,

80. *Id.* I thank Alex Raskolnikov for helpful discussions regarding this point.

81. *Id.*

nonabusive business activities.⁸² In a 2006 meeting of the Tax Executives Institute, an industry association of corporate tax directors, a lead IRS lawyer commented that “[t]oo many routine business transactions are being reported to the IRS.”⁸³ The following taxpayer and advisor reactions illustrate this type of overdisclosure.

Intermediary Corporation Tax Shelter. The IRS’s initial attempts to collect information regarding the intermediary corporation tax shelter⁸⁴ led many taxpayers and advisors to file disclosure statements regarding real, non-tax-motivated business deals.

The intermediary corporation tax shelter was a real sale between a buyer and seller that was structured “in a ‘funny’ way . . . to achieve tax benefits clearly unintended by Congress.”⁸⁵

In a typical structure, a corporation (Seller) owned stock in a target corporation (Target) that itself owned an appreciated asset, such as real estate, which another corporation (Buyer) desired to own. If Buyer were to purchase the stock of Target from Seller, Target would continue to hold real estate with a built-in taxable gain waiting to be recognized, and if Buyer were to purchase the real estate directly from Target, Target would incur immediate taxable gain.

To alleviate this potential tax cost, Seller would sell its stock in Target to an intermediary corporation (Intermediary) that had large tax losses or credits. Intermediary would then quickly cause Target to sell its real estate to Buyer.⁸⁶ After the dust settled, Intermediary and Target would file tax returns on a consolidated basis for federal income tax purposes.⁸⁷ The parties claimed that Seller recognized taxable gain only on the sale of Target stock to Intermediary, that Buyer held the real estate with a tax basis equal to its fair market

82. See, e.g., Heather Bennett, *DeNovio Clarifies IRS Disclosure Policy on Reportable Transactions*, 105 TAX NOTES 15 (2004) (including statements by Nicholas J. DeNovio, IRS Deputy Chief Counsel, asking taxpayers not to overdisclose routine business transactions); SECTION OF TAXATION, AM. BAR ASS’N, COMMENTS CONCERNING PROPOSED REGULATIONS UNDER SECTIONS 6011, 6111, AND 6112, at 11 (2007) (“Treasury and IRS officials have repeatedly acknowledged the difficulties caused by over-disclosure [of routine transactions].”).

83. Tandon, *supra* note 66, at 203 (referring to the general sentiment among IRS officials at the meeting).

84. See I.R.S. Notice 2001-16, 2001-1 C.B. 730 (describing the mechanics of the intermediary corporation tax shelter).

85. Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 TAX L. REV. 325, 337 (2002).

86. See I.R.S. Notice 2001-16, 2001-1 C.B. 730. In an alternative version of the tax strategy, instead of corporation with tax losses, the intermediary corporation might be a tax-exempt entity, like a public charity. *Id.*

87. Corporations that file consolidated federal tax returns are generally treated as a single taxable unit, where the tax losses and credits of one group member offset the tax gains of another group member. I.R.C. §§ 1502–1503 (2006).

value, and last, that Intermediary did not bear any tax liability because its tax losses or credits offset the tax gain of Target.⁸⁸

After learning that accounting firms had been actively marketing the intermediary corporation tax shelter, the IRS designated this tax strategy as a listed transaction in Notice 2001-16, thus subjecting it to mandatory disclosure.⁸⁹ The IRS argued that Intermediary should be disregarded or treated as an agent of Seller, and furthered other theories that would cause Seller to be “properly characterized” as selling the assets of Target directly to Buyer.⁹⁰ The types of transactions the IRS attempted to describe were parties’ coordinated efforts to structure their transactions to avoid federal income tax, but not serve any other real business purpose. In one case pending at the time of the IRS’s notice, taxpayers had used a Native American tribe as the intermediary, and the tribe caused the entity it acquired from the selling corporation to dispose of its assets within ten minutes of its purchase.⁹¹

In the years following the IRS’s designation of the intermediary corporation tax shelter as a listed transaction, however, some taxpayers and advisors responded by disclosing routine business transactions lacking abuse potential.⁹² Taxpayers disclosed ordinary sales of stock in which the purchaser happened to be a tax-exempt organization or a corporation with substantial tax credits.⁹³ The IRS did not intend to require disclosure of these types of transactions because they were motivated by real business purposes, not mere tax avoidance. Yet tax lawyers advised their clients to be wary that a “seller of corporate stock [could] become an unwitting participant in a ‘listed transaction’ shelter if its buyer happened to resell the assets of the acquired entity in a transaction that was sheltered by the buyer’s pre-existing tax benefits.”⁹⁴

88. I.R.S. Notice 2001-16, 2001-1 C.B. 730.

89. *See id.*

90. *See id.*

91. *See* David Cay Johnston, *US Blocks 2 Shelters Intended to Avoid Taxes*, N.Y. TIMES, Jan. 19, 2001, at C4 (discussing *John H. Phipps, Inc. v. Commissioner*, No. 9695-00 (T.C. Sept. 13, 2000), a case before the United States Tax Court, involving recharacterization of a stock sale as an asset sale due to use of Native American tribe intermediary, based on I.R.S. Notice 2001-16, 2001-1 C.B. 730).

92. *See, e.g.*, I.R.S. Notice 2008-20, 2008-6 I.R.B. 406; Letter From David S. Miller, Chair, New York State Bar Ass’n Tax Section to Eric Solomon, Assistant Secretary for Tax Policy, Dep’t of the Treasury & Douglas Shulman, Comm’r, Internal Revenue Serv. (May 23, 2008), available at http://www.nysba.org/AM/Template.cfm?Section=Tax_Section_Reports_2008&CONTENTID=16428&TEMPLATE=/CM/ContentDisplay.cfm.

93. For a discussion of this practice as it relates to hedge funds, see Michael Kosnitzky, *Protective Filings for Hedge Funds After the Jobs Act*, 109 TAX NOTES 817 (2005).

94. Wayne R. Strasbaugh, *IRS Lays Mine Field for Some Stock Transactions*, BALLARD SPAHR ANDREWS & INGERSOLL, LLP, NEWS & PUBLICATIONS, Jan. 29, 2008, available at <http://www.ballardspahr.com/press/article.asp?ID=1980>.

After reviewing the types of disclosure statements it received, the IRS acknowledged that its notice “identifying the transaction based on the role of an entity that appears to be an intermediary may result in over-disclosure.”⁹⁵

Notional Principal Contract Tax Shelters. The reaction of taxpayers and advisors to the IRS’s designation of a tax strategy involving “notional principal contracts” as a listed transaction provides another example of the overdisclosure response.⁹⁶

This strategy enabled taxpayers to exploit the rules governing notional principal contracts, and claim large tax-deductible losses that could be used to offset other unrelated taxable income.⁹⁷ Two parties, A and B, would enter into a contract lasting more than a year, in which A would make periodic payments to B based on a fixed or floating rate multiplied against a notional principal amount. B, in turn, would make a single back-end payment at the end of the contract to A. The key to this tax shelter was the structure of B’s back-end payment. A large part of the payment would consist of a non-contingent component (for example, part of the payment would be based on a specific fixed rate index) and a much smaller part of B’s back-end payment would consist of a contingent component (for example, it could depend on the market value of certain stock). By structuring the back-end payment from B to include both noncontingent and contingent components, A would claim tax deductions for its payments to B currently and would not accrue any of the back-end payment in income until it received it from B.⁹⁸ In many cases, the parties would terminate their contract prior to B’s scheduled back-end payment and A would simply reports its gain or loss on the termination of the swap agreement as a capital gain or loss.

In 2002, the IRS announced that this type of highly engineered notional principal contract was a listed transaction.⁹⁹ As a substantive legal matter, the IRS ruled in Notice 2002-35 that the tax law required taxpayers to accrue in income the noncontingent portion of B’s back-end payment “in a manner that reflects the economic substance of the contract” and that the IRS would challenge the strategy by applying various substance-over-form recharacterizations.¹⁰⁰

In response to the IRS’s notice, the Service was overwhelmed by a “flood of disclosures” from taxpayers and advisors regarding “plain vanilla”

95. I.R.S. Notice 2008-20, 2008-6 I.R.B. 406, *superseded* by I.R.S. Notice 2008-111, 2008-51 I.R.B. 1299.

96. See I.R.S. Notice 2002-35, 2002-1 C.B. 992 (describing notional principal contract tax shelters).

97. See *id.*

98. *Id.*

99. *Id.*

100. *Id.*

total return equity swaps and other nonabusive swap agreements.¹⁰¹ A total return equity swap is like the notional principal contract described above, except that the back-end payment is wholly contingent. In a total return equity swap, A makes payments to B during the term of the contract and at the end of the contract, B makes a back-end payment to A that is based solely on some contingency, such as the market change in the value of a certain company's stock.¹⁰² The total return equity swap is a customary commercial transaction motivated by genuine business purposes, not one engineered to achieve tax avoidance.¹⁰³

In 2006, the IRS conceded publicly that its notice had "caused taxpayers to file large numbers of disclosure statements on Form 8886, Reportable Transaction Disclosure Statement, for common transactions, such as total return swaps, that are entered into for bona fide non-tax purposes."¹⁰⁴

Transactions with Tax Insurance. A final example of overdisclosure of nonabusive reportable transactions is the response from taxpayers and advisors to the Treasury's initial request for disclosure of transactions in which the expected tax results were protected by tax insurance.

A taxpayer that engages in aggressive tax planning may purchase tax insurance from third-party carriers in an attempt to minimize its potential expected cost in the event that the IRS successfully challenges its claimed tax benefits.¹⁰⁵ In an early version of the tax shelter reporting rules released in 2002, the Treasury required taxpayers to disclose their participation in any transaction "for which the taxpayer has . . . contractual protection against the possibility that part or all of the intended tax consequences from the transaction will not be sustained."¹⁰⁶

After the release of these regulations, taxpayers disclosed their participation in routine, nonabusive business transactions for which they had purchased tax insurance. Taxpayers that had purchased tax insurance in connection with like-kind exchanges, for example, disclosed their participation in these exchanges to the IRS, even though Congress specifically intended for these

101. Tandon, *supra* note 66, at 203.

102. See Gina Biondo & Allison Rosier, *The Effect of the Proposed Swap Regulations on the Hedge Fund Industry: Goodbye to Total Return Swaps?*, 103 TAX NOTES 1171, 1172 (2004) (describing "plain vanilla" total return equity swap arrangements).

103. See *id.* at 1171-72.

104. I.R.S. Notice 2006-16, 2006-9 I.R.B. 538.

105. See Logue, *supra* note 2, at 343-44.

106. Temp. Treas. Reg. § 1.6011-4T(b)(4) (2002).

transactions to convey beneficial tax treatment.¹⁰⁷ Other taxpayers reported legitimate business transactions, such as mergers between public corporations, where one party to the transaction had agreed to indemnify the other party for certain tax liabilities.¹⁰⁸

After reviewing disclosure statements from taxpayers and advisors, the Treasury acknowledged the overdisclosure response, commenting that many taxpayers had interpreted the rules to require “numerous legitimate business transactions with tax indemnities [as] subject to reporting.”¹⁰⁹

2. Unnecessary Protective Disclosures

As I will argue shortly, the IRS received many of the unnecessary disclosure statements described above because some taxpayers and advisors believed that the disclosed tax strategies were reportable transactions.¹¹⁰ But taxpayers and advisors may also file these types of disclosure statements with the IRS on a protective basis in cases where they are unsure whether disclosure is even required.

The tax shelter reporting rules specifically authorize the filing of protective disclosure statements whenever taxpayers and advisors are “uncertain whether a transaction must be disclosed.”¹¹¹ The only condition is that taxpayers and advisors must provide the IRS with as much information in a protective disclosure statement regarding the disclosed transaction as they would in an ordinary disclosure statement required by law.¹¹²

Taxpayers and advisors may choose to file a protective disclosure statement for two reasons:

First, filing protective disclosure statements with the IRS shields taxpayers and advisors from high monetary penalties for failing to disclose reportable transactions.¹¹³

Second, filing protective disclosure statements relates to tax accrual work papers, documents a taxpayer prepares for internal use that reveal which

107. See Richard M. Lipton, *New Disclosure and Listing Regulations Promise Headaches for Everyone*, in 1 TENTH ANNUAL REAL ESTATE TAX FORUM 61, 74, 91 (PLI Tax Law & Estate Planning, Course Handbook Series No.14248 2008).

108. See *id.* at 74.

109. Preamble to Proposed Regulations, 71 Fed. Reg. 64496 (Nov. 2, 2006).

110. See INTERNAL REVENUE SERV., PARTNERSHIP-AUDIT TECHNIQUE GUIDE Ch. 9 (2007) (“Not all disclosures of reportable transactions disclosed to the Service are abusive.”).

111. Treas. Reg. § 1.6011-4(f)(2) (as amended in 2007).

112. *Id.*; see also Instructions for I.R.S. Form 8886, at 5 (2007), available at <http://www.irs.gov/pub/irs-pdf/i8886.pdf> (explaining that a protective disclosure form is treated the same as an ordinary disclosure form).

113. Treas. Reg. § 1.6011-4(f)(2).

of its tax positions the taxpayer believes are most questionable. For obvious reasons, taxpayers would rather not share these documents with the IRS. If a taxpayer discloses its participation in a listed transaction, or a substantially similar one, the IRS will automatically request the taxpayer's tax accrual work papers.¹¹⁴ The IRS has indicated, however, that if a taxpayer files a protective disclosure statement and explains why the disclosed transaction is not substantially similar to a listed transaction, the IRS may take a less aggressive stance and not request tax accrual work papers.¹¹⁵

Many taxpayers have filed protective disclosure statements with the IRS regarding legitimate, nonabusive business transactions, rather than tax shelters.¹¹⁶ For example, after the IRS issued its notice regarding notional principal tax shelters, one commentator noted that because hedge funds "engage in a variety of transactions . . . that may resemble reportable transactions[,] . . . hedge funds, as a common practice, have filed a protective Form 8886 even if they believed that the transaction was not listed or abusive."¹¹⁷ IRS and Treasury officials have confirmed that since the enactment of monetary penalties for failure to disclose a reportable transaction, "[p]eople are making a lot of protective disclosures"¹¹⁸ and "[s]ome are filing protective disclosures when they don't have to."¹¹⁹

3. Extraneous Details and Documentation

A final category of overdisclosure is the filing of disclosure statements containing excessive details or documents that are extraneous to the underlying tax strategies.

When a taxpayer discloses its participation in a potential tax shelter to the IRS, it must also provide a description of the transaction and the taxpayer's view of its expected tax treatment. The form a taxpayer files to disclose a

114. See Internal Revenue Serv., Tax Accrual Workpapers Frequently Asked Questions, (April 24, 2007), <http://www.irs.gov/businesses/corporations/article/0,,id=146242,00.html>.

115. *Id.* (describing IRS procedures for tax accrual work paper requests in the case of protective disclosure statements). For further discussion, see Todd Simmens, *IRS Treats Protective Disclosures Inconsistently*, 27 TAX ADVISER 426 (2006) (outlining rationale for filing protective disclosure statements).

116. George Jones, *Treasury Advisor Explains "Transactions of Interest" Disclosure Regulations Designed to Give IRS Flexibility*, CCH TAX GROUP (Aug. 31, 2007), http://www.centerfortaxstudies.com/blog/taxnews/2007/08/21/treasury_advisor_explains_aquot_transact (discussing protective disclosure filings).

117. See Kosnitzky, *supra* note 93, at 817 (2005).

118. Jones, *supra* note 116 (quoting Anita C. Soucy, Attorney-Advisor in the Treasury's Office of Tax Policy).

119. Sheryl Stratton, *Tax Bar Asks IRS to Disclose More Info About Shelter Disclosures*, 115 TAX NOTES 20, 20 (2007) (quoting Tara P. Volungis, an attorney in the IRS's Office of Associate Chief Counsel).

reportable transaction, Form 8886, contains several lines for describing any expected tax benefits, as well as the related steps of the transaction.¹²⁰

Some taxpayers provide so much information in their description that the IRS may be unable to determine solely from the disclosure statements whether the transactions have abuse potential.¹²¹ Many taxpayers have broadly interpreted the IRS's instructions to "[i]nclude facts of each step of the transaction . . . regardless of the year entered into."¹²² As a consequence, they may describe many aspects of their transactions that do not relate to the heart of a potentially abusive tax strategy. Even though Form 8886 has only seven lines for describing disclosed transactions, taxpayers routinely write "see attached pages" at the end of this space and then attach many pages to the disclosure form.¹²³ Indeed, the IRS's instructions explicitly allow for these attachments.¹²⁴

Some tax advisors engage in similar overdisclosure. Advisors are required under current law to maintain lists of any taxpayers for which they serve as material advisors, meaning they have recommended reportable transactions, been paid a minimum threshold fee, and met other requirements.¹²⁵ When the IRS has sought tax shelter investor lists from advisors, many of them have "merely provid[ed] boxes of documents in response to the list maintenance requests."¹²⁶ At a public hearing in 2007, an official from the IRS Office of Associate Chief Counsel confirmed that one challenge the IRS has faced in soliciting information from advisors is that "many of the disclosures are incomplete or provide[d in] boxes of documents without an index."¹²⁷

120. I.R.S. Form 8886 (2007), available at <http://www.irs.gov/pub/irs-pdf/f8886.pdf>.

121. See Stratton, *supra* note 119.

122. I.R.S. Form 8886, l. 7b, *supra* note 120, at 2; see also Instructions for I.R.S. Form 8886, *supra* note 112, at 6 ("Describe each step of the transaction including all information known to you.").

123. See Instructions for I.R.S. Form 8886, *supra* note 112, at 5 (providing instructions for attaching additional pages).

124. See *id.*

125. Treas. Reg. § 301.6111-3(b)(3)(i) (2007) (minimum material advisor fees).

126. Richard M. Lipton & Robert S. Walton, *Final Regulations for the Tax Shelter Disclosure Regime: Making the Rules More User Friendly*, 107 J. TAX'N 196, 203 (2007).

127. Stratton, *supra* note 119, at 20 (quoting Christine Ellison, Branch Chief in the IRS's Office of Associate Chief Counsel). This type of response to requests for information from the IRS has become embedded in popular consciousness. For example, in a scene from the 2006 film *Stranger Than Fiction*, Ana Pascal, the owner of a small café under audit by IRS agent Harold Crick, hands Crick a large box bulging with papers, commenting "My tax files and receipts for the last three years." An incredulous Crick queries, "You keep your files like this?" Pascal responds, "No. Actually I'm quite fastidious. I put them in this box just to screw with you." STRANGER THAN FICTION (Columbia Pictures, 2006).

C. Threats to Tax Administration

Overdisclosure poses serious threats to the effective and efficient administration of the tax system: it distracts the IRS from detecting abuse, slows the enactment of statutory solutions, and constitutes wasteful taxpayer behavior.

Detection Distraction. Unnecessary disclosure statements consume valuable IRS resources that could otherwise be allocated to the detection of abusive tax activity. Every reportable transaction disclosure statement is, in theory, subject to several levels of internal review within the IRS.¹²⁸ But more importantly, it is often impossible to distinguish a disclosure statement concerning an abusive tax shelter from one describing an ordinary, nonabusive transaction without thorough analysis and, often, follow-up questions to the taxpayer or advisor who filed the statement.

For example, a taxpayer that has sold stock to a tax-exempt entity may file a disclosure statement with the IRS reporting participation in an intermediary corporation tax shelter—a listed transaction.¹²⁹ There may be no way for the IRS agents in the Office of Tax Shelter Analysis to determine whether the disclosed transaction is actually part of a larger abusive scheme without investigating the roles of additional parties. If it turns out that the taxpayer filed its disclosure statement merely out of caution, and not because it participated in a transaction solely designed to avoid federal income tax, the taxpayer will have consumed hours of the IRS's attention that could have been dedicated to investigating taxpayers involved in much more questionable tax planning.

Further, the sheer volume of unnecessary disclosure statements that the IRS may receive in response to particular requests may impair its ability to review all of these requests fully, if at all. For instance, in its annual report for 2006, the Internal Revenue Service Advisory Council (IRSAC) discussed its review of the IRS's procedures for analyzing reportable transaction disclosure statements.¹³⁰ The IRSAC report explained:

Based upon meetings with [Large & Midsize Business Division] officials, IRSAC members did not initially get to a comfort level that anything had been done with these forms by [the Office of Tax Shelter

128. See INTERNAL REVENUE SERV., *supra* note 19, pt. III.A.I, at 6 (describing multiple levels of internal IRS review).

129. See *supra* notes 84–92 and accompanying text.

130. See INTERNAL REVENUE SERV. ADVISORY COUNCIL, PUBLIC MEETING BRIEFING BOOK 10–16 (2006), available at http://www.irs.gov/pub/irs-utl/2006_irsac_public_meeting.pdf.

Analysis] on a timely basis. . . . [W]e were told that these filings were stacked in an office in Ogden waiting to be processed.¹³¹

Over the course of its review, IRSAC learned that “taxpayers who have made disclosures have either had no follow-up contacts with the IRS or, alternatively, have simply received a ‘tax shelter identification number’ to include on their returns.”¹³² Because excessive reporting of ordinary transactions may cause disclosure statements that describe abusive tax planning to become lost in the shuffle, IRSAC concluded that the “IRS should implement measures to reduce overdisclosure of transactions that are not reportable transactions.”¹³³

Slowed Statutory Solutions. When the mandatory disclosure regime works well, it enables the IRS to learn about new types of abusive tax planning and, assuming taxpayers properly disclose, the scale of participation by taxpayers. IRS officials may then warn Congress that specific statutory changes are needed to halt the use of particular abusive tax strategies.¹³⁴ The government has acknowledged that a purpose of the mandatory disclosure regime is to “allow the IRS, the Treasury Department, and, to the extent necessary, the Congress sufficient time to react to and stop the spread of the latest fad in the corporate tax shelter genre.”¹³⁵ For example, shortly after the IRS discovered that many taxpayers were engaging in the contingent liability transaction that Blue Chip Co. in Part I used to avoid capital gains taxation, Congress passed a specific provision, Section 358(h) of the Internal Revenue Code, which prevented taxpayers like Blue Chip Co. from claiming large capital losses using the strategy in the future.¹³⁶

Because overdisclosure distracts the IRS, it slows its ability to alert Congress that a targeted statutory solution to “the latest fad”¹³⁷ in abusive tax planning is needed. As a result, the “Wall Street rule” may take hold, meaning taxpayers believe that the IRS or Congress will not challenge a particular tax strategy if there is “long-standing and generally accepted understanding of this expected tax treatment.”¹³⁸ Even though the Wall Street rule has no legal basis, when so many taxpayers have adopted a particular tax position, Congress may wait to change the law until after it has held hearings or the IRS and

131. *Id.* at 7–8.

132. *Id.* at 12.

133. *Id.* at 16.

134. See U.S. DEP’T OF THE TREASURY, *supra* note 45, at 84 (describing the purpose of the mandatory disclosure regime).

135. *Id.*

136. I.R.C. § 358(h) (2006) (which would prevent Blue Chip Co.’s tax loss on sale).

137. U.S. DEP’T OF THE TREASURY, *supra* note 45, at 84.

138. See Mark Battersby, *Tax Watch: The ‘Wall Street Rule’ Isn’t a Rule of Law, the IRS Insists*, INVESTMENT NEWS, October 6, 2003, at 17.

taxpayers have butted heads in court. Without the effects of overdisclosure, however, the IRS may be able to warn Congress of a particular defect in the law before its exploitation by taxpayers has spread. At that early stage, Congress may be more amenable to enacting a technical correction to the law.

Wasteful Behavior. Last, overdisclosure represents wasteful behavior. When taxpayers and advisors expend time and resources describing the details of tax strategies that are not abusive but that, technically, may be reportable transactions, they do this in place of activities that could at least provide some social benefit.¹³⁹ Just as “[n]o new medicines are found, computer chips designed, or homeless housed”¹⁴⁰ as a result of abusive tax planning, the same can be said of overdisclosure. The efforts of taxpayers and advisors could be justified if the government were to collect additional revenue as a result of the information they provide. But in the case of overdisclosure, where the tax strategies disclosed are consistent with both the letter and spirit of the underlying tax law, the government fails to collect additional revenue.

III. WHY OVERDISCLOSURE? INVESTIGATING THE SOURCES

The discussion so far has provided concrete evidence that the threat of overdisclosure is real, but it has not addressed the fundamental question of why it occurs. Without understanding the sources of overdisclosure, it would be difficult to consider and implement effective measures for preventing it.

The overdisclosure response does not stem solely from any single feature of the tax law or tax administration. Rather, it is the result of a number of factors, the relevance of which may vary depending on the type of taxpayer or advisor that is subject to the mandatory disclosure regime. As this Part argues, current law contains numerous overdisclosure incentives for conservative types inclined to cooperate with the IRS, and for aggressive types that want to obstruct its search for tax shelter clues.

139. See Michael Schler, *Effects of Anti-Tax-Shelter Rules on Nonshelter Tax Practice*, 109 TAX NOTES 915 (2005) (“Every law firm in the country has been required to make an enormous effort to develop, and ensure ongoing compliance with, procedures relating to those transactions.”).

140. Weisbach, *supra* note 31, at 222. Worse, it is theoretically possible that some taxpayers may actually engage in nonabusive transactions so that they can disclose participation in them to the IRS in addition to disclosing the use of much more questionable transactions. The motivation of taxpayers and advisors who may purposely overdisclose nonabusive transactions to the IRS is discussed further in Part III.C, *infra*.

A. Different Attitudes Toward Tax Compliance

Different taxpayers and advisors have different attitudes toward tax compliance.¹⁴¹

Some may act cautiously, attempting to comply with the tax law to the fullest extent possible. Cautious taxpayers are unlikely to claim risky tax positions on their tax returns, and certainly would not knowingly violate the tax law. Similarly, there are tax advisors who fit this model. Conservative advisors avoid recycling standard opinions that do not fully consider the factual elements of particular clients' transactions. Rather, as Peter Canellos has written, these types of advisors view tax law as a practice area that is "interactive, interpersonal, and calls for negotiating as well as analytical skills."¹⁴²

Other types of taxpayers and advisors may view the IRS as an adversary and tax compliance as a game in which the objective is to pay the lowest amount of tax possible. Aggressive taxpayers hope to win the audit lottery by escaping IRS detection, a gamble that has incredibly favorable odds for the taxpayer.¹⁴³ These types of taxpayers turn to advisors who are known to apply hyper-literal readings of the Internal Revenue Code without regard to Congress's intent or conflicting case law. Canellos has distinguished tax shelter lawyers from the rest of the tax bar by describing them as of "a different breed, by experience, temperament, reputation, and calling."¹⁴⁴ What Canellos and others are saying is that certain taxpayers and advisors have a tendency to push the envelope by playing within the rules, but only by reading those rules as literally as possible.¹⁴⁵

The identity of a particular taxpayer or advisor as a conservative or aggressive type may play a crucial part in the explanation of why overdisclosure occurs.

Conservative taxpayers and advisors who are unlikely to claim risky tax positions also adopt a cautious reading of the tax shelter reporting rules. Indeed, these taxpayers and advisors may be so cautious that they would rather provide information about their transactions, even when they doubt such disclosure is required, rather than risk the consequences under current law that apply to acts of under- and nondisclosure. While these types of

141. See, e.g., Claire A. Hill, *The Law and Economics of Identity*, 32 QUEEN'S L.J. 389 (2007) (describing identity benefits and tradeoffs of tax avoidance for different taxpayers); Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement*, 109 COLUM. L. REV. (forthcoming May 2009) (characterizing taxpayers as "gamers" versus "non-gamers").

142. Canellos, *supra* note 20, at 55.

143. See Bankman, *supra* note 45, at 1782 (discussing audit lottery).

144. Canellos, *supra* note 20, at 56.

145. See Nanette Byrnes & Louis Lavelle, *The Corporate Tax Game*, BUS. WK., Mar. 31, 2003, at 78 (discussing taxpayers' "willingness to push the envelope").

taxpayers and advisors provide unhelpful information to the IRS, they at least provide it in the spirit of compliance with the law.

Aggressive taxpayers and advisors, on the other hand, often attempt to claim tax positions that are inconsistent with the purposes of the statutes on which they rely, but that do not raise red audit flags for the IRS. These taxpayers and advisors are prototypical rational actors—for them, as the risk of an IRS audit increases, the expected benefit of an abusive tax position decreases. Unlike conservative taxpayers and advisors, aggressive types may overdisclose nonabusive transactions and irrelevant information to the IRS because they expect to benefit from this behavior.

B. Why Conservative Types Overdisclose

When deciding whether they should report their ordinary, nonabusive transactions to the IRS, conservative taxpayers and advisors may lean in the direction of disclosure for three primary reasons: the tax shelter reporting rules are extremely broad, the IRS often fails to offer timely explanatory guidance, and the penalties for failure to disclose are high.

1. Broad Disclosure Requests

The mandatory disclosure regime contains broad requests for information about transactions that may bear typical tax shelter traits. As the following examples illustrate, this breadth may cause conservative taxpayers and advisors to provide the IRS with information that does not aid its search for abusive tax shelters.

Substantial Similarity. Even though the tax shelter reporting rules require disclosure of a transaction when it is “substantially similar” to a listed transaction or a transaction of interest,¹⁴⁶ the threshold for disclosure is much lower than the name of this concept suggests. Under the regulations, taxpayers and advisors must disclose any transaction that is “expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy.”¹⁴⁷ This definition thus sets the threshold for disclosure at whether the transactions or underlying tax strategies are merely “similar.” As one practitioner has commented, “‘Substantially similar’ as defined in the regulations has nothing to do with substantially similar.”¹⁴⁸

146. Treas. Reg. § 1.6011-4(c)(4) (as amended in 2007).

147. *Id.* (emphasis added).

148. Terence F. Cuff, *Los Angeles Practitioner Comments on Shelter Regs*, 100 TAX NOTES 1059, 1067 (2003).

The tax shelter reporting rules do not explicitly provide for any threshold of reasonableness in defining substantial similarity.¹⁴⁹ In the tax shelter disclosure context, the standard requires taxpayers and advisors to disclose participation in transactions that are merely “similar” to listed transactions or transactions of interest.¹⁵⁰ The definition in the regulations makes no reference to the perception of a reasonable person at all. Indeed, they require the term to be “broadly construed in favor of disclosure,”¹⁵¹ effectively eliminating a minimal threshold of reasonableness for taxpayers who choose to apply this instruction literally.

When conservative taxpayers and advisors have provided the IRS with disclosure statements regarding nonabusive transactions in the past, their behavior may have been the result of broad application of the substantial similarity requirement. The New York State Bar Association Tax Section, for example, reported that in response to the IRS’s designation of the intermediary corporation tax shelter as a listed transaction, many taxpayers disclosed their participation in routine sales of stock to tax-exempt entities because they were “concerned that their transactions might be viewed as ‘substantially similar’ to the one described in [the Notice].”¹⁵²

In spite of the threat of overdisclosure, the government has consistently endorsed an expansive interpretation of “substantial similarity.” The regulations defining the term explicitly require that “the term substantially similar must be broadly construed in favor of disclosure.”¹⁵³ Responding to complaints that the substantial similarity requirement creates uncertainty regarding whether certain nonabusive transactions must be disclosed, an IRS official commented in 2006 that as a result of the substantial similarity requirement, “If I were in your shoes and I wasn’t sure, I would disclose”¹⁵⁴

149. By contrast, courts in copyright infringement disputes involving such cases consider whether a defendant has produced a work “substantially similar” to that of the plaintiff by asking “whether the accused work is so similar to the plaintiff’s work that an ordinary reasonable person would conclude that the defendant unlawfully appropriated the plaintiff’s protectible expression by taking material of substance and value.” *Atari, Inc. v. N. Am. Phillips Consumer Elecs. Corp.*, 672 F.2d 607, 614 (7th Cir. 1982). In other words, under this standard, judges seek to determine whether an ordinary reasonable person would find two works to be basically the same except for “minute differences.” *Country Kids ’N City Slicks, Inc. v. Sheen*, 77 F.3d 1280, 1288 (10th Cir. 1996). Without this standard, in a copyright infringement case, as Judge Learned Hand once wrote, “a plagiarist would escape [liability] by immaterial variations.” *Nichols v. Universal Pictures Corp.*, 45 F.2d 119, 121 (2d Cir. 1930).

150. Treas. Reg. § 1.6011-4(c)(4).

151. *Id.*

152. Letter From David S. Miller to Eric Solomon & Douglas Shulman, *supra* note 92, at 3.

153. Treas. Reg. § 1.6011-4(c)(4).

154. Tandon, *supra* note 66, at 203.

No Abuse Necessary. Current law also encourages conservative types to overdisclose by requiring disclosure of specified activities, whether or not they actually are abusive. A core objective of the mandatory disclosure regime is to highlight for IRS agents the tax positions that may be the result of abusive tax planning.¹⁵⁵ The tax shelter reporting rules do not absolve taxpayers from the disclosure obligation simply because a particular transaction does not result in understatement of tax liability, or is supported by a valid non-tax-related business purpose.¹⁵⁶

For example, if a taxpayer participates in a transaction that is identical to the contingent liability tax shelter—a listed transaction¹⁵⁷—the taxpayer is obligated to disclose its participation even if it believes that the transaction served a real business purpose unrelated to tax avoidance.¹⁵⁸ In fact, in the notice designating this particular tax strategy as a listed transaction, the IRS stated its view that “any business purposes taxpayers may assert for certain aspects of these transactions are far outweighed by the purpose to generate deductible losses for federal income tax purposes.”¹⁵⁹ The IRS, thus, wants to see the details of the reportable transaction whether or not a taxpayer or advisor believes it constitutes abuse.

The drawback to this strong stance is that cautious, conservative taxpayers and advisors may feel an obligation to disclose any transactions that arguably fall within one of the required disclosure categories, even if they clearly lack abuse potential. After all, if the transactions really are not abusive, disclosure poses little risk to the taxpayer. Managers of hedge funds may have reported so many plain vanilla total return equity swaps because the managers broadly interpreted the IRS’s designation of the abusive notional principal contract tax shelter as a listed transaction.¹⁶⁰ As commentators reported, there was little downside to disclosing these types of transactions, given their consistency with the tax law.¹⁶¹

Retroactivity. Conservative taxpayers may also be motivated to overdisclose because the tax shelter reporting rules may apply to taxpayers’ transactions on a retroactive basis.

If the IRS designates a particular strategy as a listed transaction after taxpayers have used it, taxpayers are nonetheless required to disclose

155. See INTERNAL REVENUE SERV., *supra* note 19, pt. III.A.1, at 6 (describing the purposes of mandatory disclosure).

156. H.R. REP. NO. 108-755, at 373, 447 (2004) (Conf. Rep.).

157. I.R.S. Notice 2001-17, 2001-1 C.B. 730.

158. Treas. Reg. § 1.6011-4(b)(2).

159. I.R.S. Notice 2001-17, 2001-1 C.B. 730.

160. See Kosnitzky, *supra* note 93, at 817.

161. See *id.*

participation in the strategy retroactively (as long as the applicable statute of limitations has not expired).¹⁶² Likewise, taxpayers must report transactions of interest retroactively.¹⁶³

Without a retroactivity provision, the mandatory disclosure regime would be so weak as to be nearly useless. As has been discussed, the most popular tax shelters are those that are not explicitly prohibited by law or even subject to disclosure requirements.¹⁶⁴ When it comes to abusive tax shelters, the IRS is constantly playing a cat-and-mouse game with taxpayers and tax shelter promoters.¹⁶⁵ Retroactive disclosure requirements, consequently, are necessary for the IRS to receive disclosure statements regarding these transactions from the taxpayers and advisors that first participated in them.

Retroactive reporting rules, however, may cause conservative taxpayers to overdisclose. An IRS announcement requiring taxpayers to disclose a listed transaction may cause a taxpayer to evaluate several years of transaction history to determine whether it has engaged in the transaction or one substantially similar to it. Taxpayers have commented that the retroactivity feature results in record-keeping burdens, especially in the corporate context where tax directors may retire or resign before the IRS designates a particular transaction as subject to mandatory disclosure.¹⁶⁶ Further, taxpayers must disclose participation in any such transaction within ninety calendar days after it becomes a listed transaction or transaction of interest.¹⁶⁷ Conservative taxpayers, consequently, may disclose on a protective basis at the time they enter into transactions rather than wait for an IRS announcement requiring disclosure.

2. Slow Explanatory Guidance

Conservative taxpayers and advisors may also err on the side of overdisclosure because the IRS is often slow to explain how the tax shelter reporting rules should be applied to transactions that, to taxpayers and advisors, appear nonabusive.

When the IRS issues angel lists, it announces that certain clearly nonabusive transactions and tax strategies are exempt from the mandatory disclosure regime. The IRS can issue an angel list in the form of a notice that supersedes a prior notice, or as a stand-alone revenue procedure. These lists are designed

162. Treas. Reg. § 1.6011-4(e)(2)(i).

163. *Id.*

164. See Chirelstein & Zelenak, *supra* note 65, at 1940–42.

165. See generally *id.*

166. Cuff, *supra* note 148, at 1069–70.

167. Treas. Reg. § 1.6011-4(e)(2)(i).

to alleviate uncertainty regarding disclosure and to prevent the IRS from receiving disclosures of obviously nonabusive tax strategies.

While the IRS has issued angel lists for certain categories of reportable transactions,¹⁶⁸ it has been slow or unwilling to clarify what types of transactions are not substantially similar to a listed transaction or transaction of interest. IRS officials have often resisted public calls for such guidance, citing a concern that taxpayers and advisors may exploit it to avoid disclosing abusive transactions.¹⁶⁹

In the rare cases in which the IRS has issued angel lists clarifying a notice that designated a particular tax strategy as a listed transaction, it has done so years after the original notice. For example, after the IRS first required taxpayers to disclose participation in the notional principal contract tax shelter in 2002, taxpayers and advisors quickly questioned whether the IRS meant to capture plain vanilla total return equity swap transactions with its original notice.¹⁷⁰ Despite this concern, the IRS did not issue a corrective notice exempting such nonabusive transactions from disclosure until nearly four years had elapsed.¹⁷¹

As a result of the IRS's reluctance to issue angel lists clarifying the scope of its disclosure requests, conservative taxpayers and advisors frequently disclose nonabusive transactions. In the four years between the IRS's original notice regarding notional principal contract tax shelters and its corrective guidance, taxpayers and advisors filed "tens of thousands of unnecessary disclosures" regarding total return equity swaps and other nonabusive transactions.¹⁷²

Further, because the IRS often allows so much time to pass before issuing corrective guidance, some conservative taxpayers and advisors may adopt an overly cautious stance toward the mandatory disclosure regime. These taxpayers and advisors may not change their disclosure behavior even after the IRS includes certain nonabusive transactions on an angel list.

168. See, e.g., I.R.S. Notice 2006-16, 2006-9 I.R.B. 538 (exempting nonabusive transactions from the requirement to disclose abusive notional principal contract tax shelters); Rev. Proc. 2007-20, 2007-7 I.R.B. 517 (describing agreements with contractual protection that are not required to be disclosed); Rev. Proc. 2004-66, 2004-50 I.R.B. 966 (describing loss transactions that are not required to be disclosed).

169. See, e.g., Bennett, *supra* note 82, at 15. In response to a question regarding the likelihood that the IRS would issue guidance regarding overdisclosure, Nicholas J. DeNovio, IRS Deputy Chief Counsel commented, "it is unlikely that the government would issue guidance based on what it observes about disclosures." *Id.*

170. See *supra* note 96 and accompanying text.

171. The IRS issued the original notice on May 6, 2002 and the corrective guidance on February 13, 2006. See I.R.S. Notice 2006-16, 2006-9 I.R.B. 538; see also *infra* note 247 and accompanying text.

172. See INTERNAL REVENUE SERV. ADVISORY COUNCIL, *supra* note 130, at 12.

As an illustration, after the IRS issued Notice 2008-20 in 2008, which redefined an intermediary corporation tax shelter by using four objective factors rather than a more general description,¹⁷³ some practitioners advised their clients to continue, if not increase, disclosure of nonabusive transactions.¹⁷⁴ They advised that, as a result of the corrective guidance, there are now “virtually ‘no excuses’ [for failing to file a disclosure statement] for stock transactions that happen to satisfy the [four] basic requirements of an intermediary transaction tax shelter.”¹⁷⁵ The New York State Bar Association Tax Section echoed this sentiment, writing that “[i]n the face of this uncertainty, it has been suggested that a taxpayer should file a protective disclosure [regarding nonabusive transactions] or request a ruling”¹⁷⁶ An IRS official has acknowledged concern that taxpayers and advisors may respond to the new notice with “excessive reporting of transactions based on the uncertainty of the intentions of other parties to them.”¹⁷⁷

3. Fear of Nondisclosure Penalties

The current penalties for failing to comply with the mandatory disclosure regime are severe. As the following discussion explains, these penalties, when combined with broad reporting rules and limited explanatory guidance, have made overdisclosure a sensible strategy for conservative taxpayers and advisors.

Monetary Penalties. In 2004, in response to the growing mass-marketed tax shelter industry, Congress enacted new tax penalties for taxpayers and advisors that fail to file required disclosure statements.¹⁷⁸

173. I.R.S. Notice 2001-16, 2001-1 C.B. 730 (original notice describing intermediary corporation tax shelter).

174. Steven D. Bortnick, *Beware the Inadvertent Tax Shelter*, TAX UPDATE (Pepper Hamilton LLP) June 2008, at 4, available at <http://www.pepperlaw.com/pepper/publications>.

175. Strasbaugh, *supra* note 94. In addition, when the IRS has issued public announcements designating tax strategies as transactions of interest, it has not provided substantive legal analysis of the strategies described. See, e.g., I.R.S. Notice 2007-72, 2007-36 I.R.B. 544 (no “Analysis” section).

176. Letter From David S. Miller to Eric Solomon & Douglas Shulman, *supra* note 92.

177. Sam Young, *No Immediate Relief From ‘Midco’ Transaction Notice*, 119 TAX NOTES 1304, 1304 (2008). Shortly before this Article was published, the IRS attempted to respond to this concern by issuing a revised notice, I.R.S. Notice 2008-111, 2008-51 I.R.B. 1299, containing an additional factor to its definition of the intermediary corporation tax shelter. The revised Notice incorporates into the definition the existence of a “plan” to avoid federal income tax on the disposition of appreciated assets, and describes ways in which a taxpayer “knows or has reason to know the transaction is structured to effectuate the Plan.” I.R.S. Notice 2008-111, 2008-51 I.R.B. 1299, 1300. This Notice is further discussed in Part IV.A, *infra*.

178. See STAFF OF THE JOINT COMM. ON TAXATION, 108TH CONG., DESCRIPTION OF H.R. 4520, THE “AMERICAN JOBS CREATION ACT OF 2004” 150 (Comm. Print 2004) (discussing reasons for penalties).

For taxpayers, the penalty for failing to report a listed transaction is \$100,000, in the case of individuals,¹⁷⁹ and \$200,000, in the case of corporations,¹⁸⁰ for each act of nondisclosure. These penalties are reduced to \$10,000 for individuals¹⁸¹ and \$50,000 for corporations¹⁸² in the case of nondisclosure of any other type of reportable transaction. The monetary penalties effectively apply on a strict liability basis and “without regard to whether the transaction ultimately results in an understatement of tax.”¹⁸³ The ability of the IRS to waive these penalties is also subject to record-keeping requirements and potential oversight by Congress.¹⁸⁴

Further, for taxpayers who fail to disclose any type of reportable transaction, a significant purpose of which is tax avoidance, the penalties that may apply to the understatement of tax increase from 20 percent to 30 percent.¹⁸⁵

The tax law also imposes high monetary penalties on advisors that fail to comply with the mandatory disclosure regime. If an advisor does not file a disclosure statement regarding a listed transaction, the advisor is subject to a monetary penalty of \$200,000 or 50 percent of the gross income it earned for providing advice regarding the transaction, whichever is greater.¹⁸⁶ In addition, if a material advisor fails to provide a required tax shelter investor list to the IRS within twenty days of the IRS’s request, the advisor is fined \$10,000 per day until the IRS receives the list.¹⁸⁷

Conservative taxpayers and advisors may feel obligated to disclose nonabusive transactions as a result of the monetary penalties that apply to acts of nondisclosure. A corporate tax director may be concerned that a routine business restructuring involving liabilities and corporate subsidiaries could have a remote chance of being considered substantially similar to a listed transaction.¹⁸⁸ Filing a disclosure statement with the IRS guarantees that the corporation is protected against the high penalties.¹⁸⁹

179. I.R.C. § 6707A(b)(2)(A) (2006).

180. *Id.* § 6707A(b)(2)(B).

181. *Id.* § 6707A(b)(1)(A).

182. *Id.* § 6707A(b)(1)(B).

183. H.R. REP. NO. 108-755, at 373 (2004) (Conf. Rep.).

184. I.R.C. § 6707A(d)(3).

185. *Id.* § 6662A(c) (2006).

186. *Id.* § 6707(b)(2).

187. *Id.* § 6708(a)(1) (2006).

188. I.R.S. Notice 2001-17, 2001-1 C.B. 730 (contingent liability tax shelter).

189. Analogous responses have occurred in other areas of the law. For example, some torts scholars have argued that the threat of liability for failure to provide consumers with adequate warning labels on products “induces manufacturers to provide extensive and often excessive disclosure at the cost of sacrificing clarity and salience for vital information.” Howard Latin, “Good” Warnings, *Bad Products*, and *Cognitive Limitations*, 41 UCLA L. REV. 1193, 1293 (1994).

Likewise, conservative tax advisors may file reportable transaction disclosure statements in similar situations, especially if the client has done so. And the threat of a never-ending \$10,000-a-day penalty for tax advisors¹⁹⁰ who fail to provide complete tax shelter investor lists to the IRS upon request may also motivate these advisors to maintain more records than necessary.

Shaming Penalties. Certain taxpayers may also overdisclose out of fear of reputational harm that may result from failing to comply with the mandatory disclosure regime.

The government is generally prohibited from publicly disclosing information about particular tax returns, including any penalties paid.¹⁹¹ However, Congress enacted legislation in 2004 that requires large corporate taxpayers to announce any nondisclosure penalties they have paid to the IRS in their public filings with the Securities and Exchange Commission.¹⁹² The statute is consistent with typical government shaming mechanisms that publicly highlight an offender's bad act, to punish the offender and deter others.¹⁹³

A shaming sanction for failure to disclose information to the IRS may cause some conservative tax directors to fear reputational harm for their corporations or for themselves. As opposed to publicity that a corporation's managers have claimed aggressive tax positions that are not explicitly prohibited,¹⁹⁴ public reports that a corporation's managers have simply failed to provide requested information to the IRS could send a negative signal to members of the corporation's community. Corporate managers may worry that investors and potential business partners could interpret news of a nondisclosure penalty as reflecting the level of the corporation's managers' openness and honesty.

In response to these sanctions, tax directors, lawyers, and accountants have engaged in numerous public discussions on procedures that corporations should adopt to ensure they comply with the IRS's disclosure requirements.¹⁹⁵ The most obvious response, they often conclude, is that when in doubt, overdisclosure minimizes reputational risk for their corporations.

190. I.R.C. § 6708(a)(1).

191. *See id.* § 6103 (2006).

192. *Id.* § 6707A(e) (2006).

193. *See, e.g.,* Toni M. Massaro, *Shame, Culture, and American Criminal Law*, 89 MICH. L. REV. 1880, 1883 (1991); James Q. Whitman, *What Is Wrong With Inflicting Shame Sanctions?*, 107 YALE L.J. 1055, 1063–68 (1998).

194. *See* Blank, *supra* note 2.

195. *See, e.g.,* Christian M. McBurney, *Public Companies Need to Identify Reportable Transactions to Avoid SEC Disclosure and IRS Penalties*, 103 J. TAX'N 5 (2005) (outlining procedures that tax directors should adopt to avoid disclosure failures); Herbert N. Beller, *The New Penalty Regime: Proceed With Caution!*, 106 TAX NOTES 311 (2005) (describing the significance of shaming sanctions for nondisclosure).

C. Why Aggressive Types Overdisclose

While conservative types may overdisclose information to the IRS out of fear of the consequences of nondisclosure, aggressive types may engage in this behavior for very different reasons. Aggressive taxpayers, the type that claim risky tax positions exploiting ambiguities in the tax law, and their aggressive advisors may embrace overdisclosure as an affirmative strategy for avoiding detection by the IRS. Just like typical tax shelter transactions, intentional acts of overdisclosure are “perfectly legal.”¹⁹⁶ In addition, public statements from IRS officials regarding the difficulty that overdisclosure has caused the IRS signals to aggressive types that it is likely an effective detection avoidance strategy.

1. Detection Avoidance

Overdisclosure may enable aggressive taxpayers and advisors to conceal their questionable tax strategies without risking high nondisclosure penalties.

In terms of substantive tax planning, a key objective for aggressive taxpayers is to find ways to avoid paying taxes without raising red flags for IRS auditors.

As Alex Raskolnikov has described, an aggressive taxpayer often chooses a tax avoidance strategy that does not cause items on her tax return to vary dramatically from those on her prior tax returns or from those on the tax returns of other taxpayers who fit her profile.¹⁹⁷ Applying Raskolnikov’s explanation, a suburban dentist will probably not attempt to claim a \$100 tax loss attributable to almond farming, a deduction she has never claimed before and attributable to an activity in which she has little or no actual involvement.¹⁹⁸ Rather, the dentist is more likely to claim \$100 of phony charitable deductions if she also claims \$1000 of legitimate charitable deductions on her tax return and has done so for years.¹⁹⁹ The latter strategy would probably seem more attractive to the dentist because she believes that the chances of the IRS detecting the phony \$100 charitable deduction, which is mixed in with the legitimate \$1000 of charitable deductions, are much lower than the chances of the IRS detecting the \$100 of phony almond farm deductions.²⁰⁰

Overdisclosure enables aggressive taxpayers to avoid detection by the IRS using different means. Rather than burying a small illegitimate deduction on the same line as a larger legitimate deduction on its tax return, overdisclosure

196. JOHNSTON, *supra* note 28.

197. Raskolnikov, *supra* note 13, at 572.

198. *See id.*

199. *See id.*

200. *See id.*

allows an aggressive taxpayer to provide the IRS with pure information about nonabusive transactions. When the aggressive taxpayer simultaneously files a disclosure statement regarding a truly abusive tax strategy, IRS may be so distracted by the filings regarding nonabusive transactions that it will not question the strategy.

As a result, an aggressive taxpayer may conclude that with the overdisclosure technique, the overall expected utility of engaging in the abusive transaction will not be any lower than the expected utility would be in the absence of disclosure.²⁰¹ And overdisclosure will allow the aggressive taxpayer to escape the high monetary and non-monetary penalties for failure to disclose.

Imagine that an aggressive tax director at a large corporation, acting on advice purchased from an accountant, implements a highly complex tax shelter strategy unknown to the IRS that allows his corporation to avoid millions in tax liability. The accountant promises the tax director to refund 50 percent of his fee if the IRS successfully challenges the tax treatment. The refund feature subjects this tax shelter to “contractual protection,” so the tax director is required to disclose the corporation’s use of it to the IRS.²⁰²

The tax director can avoid the nondisclosure penalties by filing a reportable transaction statement regarding this tax shelter strategy with the IRS. But at the same time, the tax director can also file unnecessary reportable transaction statements regarding any nonabusive transactions for which the corporation was entitled to a refund of fees by a tax advisor. The technical justification for the aggressive tax director’s affirmative overdisclosure is that the tax shelter reporting rules cast a wide net when describing transactions with contractual protection.²⁰³ If the rules are applied broadly, as one practitioner has commented, “[p]ractically any transaction has the potential of a refund of fees or a legal claim against the professionals if the tax work is found to be below prevailing standards.”²⁰⁴

There are several reasons why the aggressive tax director in this example may believe overdisclosure will enable him to report the abusive tax shelter without raising a red flag for the IRS.

The tax director may believe that by providing so much information about real transactions, there will only be a small chance that the IRS will

201. The reason for this result is that the aggressive taxpayer may believe that if he engages in overdisclosure, the chance the IRS will successfully detect and challenge a dubious tax position will not increase significantly, or at all, over the chance of IRS detection in the absence of filing of the required reportable transaction disclosure statement. I thank Sarah Lawsky for helpful discussions regarding this point.

202. Treas. Reg. § 1.6011-4(b)(4) (as amended in 2007).

203. *Id.*

204. Cuff, *supra* note 148, at 1067.

focus on the one disclosure statement regarding the abusive tax strategy. The IRS may instead seek additional information about one of the nonabusive transactions. Just as the leprechaun hides his gold beneath a ragwort plant adorned with a red ribbon among hundreds of other ragwort plants adorned with red ribbons,²⁰⁵ the tax director may use the overdisclosure technique to obscure truly questionable transactions from view.

As has been discussed, overdisclosure may become the norm in response to a particular reportable transaction requirement because many conservative tax directors apply an overly cautious reading of the tax shelter reporting rules.²⁰⁶ An aggressive tax director can essentially piggyback on the behavior of conservative tax directors by engaging in overdisclosure as well. By overdisclosing in order to hide an abusive tax shelter, the aggressive tax director's behavior may resemble that of conservative types, reducing the probability that the IRS will focus on the aggressive tax director's filings.

The aggressive tax director may also believe that overdisclosure is an effective detection avoidance strategy because of the statute of limitations. If a taxpayer fails to disclose a listed transaction, the statute of limitations remains open.²⁰⁷ But if the aggressive tax director files a disclosure statement regarding the abusive tax strategy, along with many disclosures of nonabusive transactions, the statute of limitations clock on the abusive strategy begins to tick. It may expire within as little time as three years from the filing of the corporation's tax return.²⁰⁸ Once the statute of limitations clock stops, absent fraud or another special exception, the IRS will not be able to challenge tax benefits the corporation has claimed using the abusive tax shelter.²⁰⁹

Aggressive advisors may also pursue a strategy of intentional overdisclosure, but for slightly different reasons than aggressive taxpayers. The aggressive advisor, such as the accountant in the example above, wants to sell his tax shelter product to as many taxpayers as possible before the IRS detects the strategy and designates it as a listed transaction.²¹⁰ Again, such notices chill the market for that particular abusive tax shelter. By overdisclosing, the advisor

205. ANNA FRANKLIN, *THE ILLUSTRATED ENCYCLOPAEDIA OF FAIRIES* 155 (Paper Tiger, 2005). In the legend, a farmer demands that a leprechaun reveal the location of his gold. When the leprechaun shows the farmer the ragwort plant under which he has buried the gold, the farmer ties a red ribbon to it while he leaves to find a shovel. When the farmer returns, he discovers that the leprechaun has tied red ribbons to every ragwort plant in the field. *Id.* I thank Larry Zelenak for suggesting this analogy.

206. See *supra* notes 146–167 and accompanying text.

207. I.R.C. § 6501(c)(10) (2006).

208. *Id.* § 6501(a).

209. *Id.*

210. See Bankman, *supra* note 45, at 1781–82.

avoids high penalties for failure to disclose, and may also reduce the chance of the IRS detecting the abusive tax strategy, enabling him to continue selling it.

2. It's "Perfectly Legal"

In light of the potential benefits of overdisclosure for aggressive taxpayers and advisors, these types may be especially drawn to the "it's perfectly legal" response to the mandatory disclosure regime because the law neither explicitly nor implicitly prohibits it.

No Disclosure Limits. The law contains very few limits on disclosure that would prevent an aggressive taxpayer or advisor from intentionally reporting participation in nonabusive transactions.

Taxpayers and advisors can file as many reportable transaction disclosure statements as they want to file.²¹¹ Aggressive types may take advantage of the protective disclosure filing mechanism, which allows them to file disclosure statements whenever they could plausibly claim to be unsure whether a particular transaction must be disclosed.²¹² Further, the regulations now require protective disclosure statements to include the same information that they would include on a nonprotective disclosure statement.²¹³ Aggressive taxpayers and advisors can exploit this procedure, by filing detailed disclosure statements that describe nonabusive transactions with a tenuous basis for disclosure.

Likewise, there is no limit on the number of words or pages a taxpayer or advisor may use to describe a reportable transaction when filing a disclosure statement with the IRS. The only limit on the description of the transaction is that it must explain the transaction "in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction."²¹⁴ Aggressive types can interpret the term "sufficient detail" as requiring taxpayers and advisors to provide the IRS with more rather than less information about a transaction, especially when considering other regulations that instruct taxpayers and advisors to disclose excess information when in doubt.

While there are more restrictions on the disclosure practice of advisors than taxpayers, they do not limit advisors' ability to pursue many forms of overdisclosure. For example, advisors are no longer permitted to deliver an unorganized box of documents to the IRS in response to a tax shelter investor request, and under current law, an index and a particular IRS form must accom-

211. Treas. Reg. § 1.6011-4(e)(3) (as amended in 2007).

212. *Id.* § 1.6011-4(f)(2).

213. *Id.*

214. *Id.* § 1.6011-4(d).

pany the documents.²¹⁵ Yet despite these rules, advisors may still intentionally disclose information regarding taxpayers and transactions that do not reveal abuse as long as they do so using the IRS form and in an organized fashion.

Lack of Authority. The tax law provides that every taxpayer is required to “carefully prepare his return and set forth fully and clearly the information required to be included therein.”²¹⁶ In spite of this provision, an aggressive taxpayer may still file as many disclosure statements regarding nonabusive transactions as possible, so long as there is some basis for considering these transactions to be subject to the reportable transaction rules. The regulation’s statement of the taxpayer’s filing obligation may not change the incentive for an aggressive taxpayer to include many unnecessary details in a description of a reportable transaction as long as the taxpayer presents them “clearly.”²¹⁷

It is also unlikely that excessive reporting of nonabusive transactions and information irrelevant to tax shelter detection would constitute fraud for tax purposes. As Congress first defined the term in 1934, “fraud” for tax purposes means “fraud with intent to evade tax.”²¹⁸ Fraud usually involves explicit lying to the IRS, such as where taxpayers claim personal exemptions for children that do not exist or taxable losses for business expenses never incurred.²¹⁹ When aggressive types file unnecessary disclosure statements, on the other hand, they describe transactions and events that have actually occurred. As the author of the leading tax procedure treatise commented on the distinction between fraud and other types of behavior,

[T]he deception and misleading conduct characteristic of fraud distinguishes fraud from tax avoidance devices. Both may result in underpayments in tax, but tax avoidance is characterized by disclosure of transactions that are, in fact, what they appear to be, for example, a sale that is not a sham as a matter of fact, or a sale that takes place on the date stated.²²⁰

Further, it is unlikely that the IRS could prove the necessary intent standard by clear and convincing evidence. The tax shelter reporting rules, after all, state that key disclosure requirements “must be broadly construed in favor of disclosure.”²²¹

215. I.R.S. Form 13976 (2008), available at <http://www.irs.gov/pub/irs-pdf/f13976.pdf>.

216. Treas. Reg. § 1.6011-1(b) (as amended in 2007).

217. *Id.*

218. I.R.C. § 293(b) (1934).

219. MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 7B.02[3][a] (WG&L 2005) (describing evidence of fraud).

220. *Id.* ¶ 7B.01 [3].

221. Treas. Reg. § 1.6011-4(c)(4) (as amended in 2007).

No Penalties. Finally, aggressive taxpayers may excessively report nonabusive transactions because the law contains no explicit monetary penalties for overdisclosure. As the discussion in Part II.B.3 indicates, since 2004, the law has contained extensive monetary and non-monetary penalties for taxpayers that fail to disclose their participation in reportable transactions.²²² However, the tax law fails to provide aggressive types with an explicit disincentive for adopting an affirmative strategy of overdisclosure.

3. Awareness

Last, aggressive types may overdisclose as a result of the IRS's own publicity of the difficulties overdisclosure has caused the Service.

Government officials have frequently discussed the overdisclosure problem in presentations at meetings of corporate tax directors, bar associations, and other public events, pleading publicly with those in attendance to reduce their overdisclosure of ordinary business transactions.²²³ For example, at a 2004 meeting of the Tax Executives Institute, an IRS official implored the attendees, "We ask you not to contort the regs regarding disclosure We don't think it is necessary to contort the regs for overdisclosure of routine issues."²²⁴ Such public statements alert aggressive taxpayers and advisors that overdisclosure may be an effective technique for avoiding IRS detection of questionable tax positions, and that the IRS has little means to prevent the response other than public pleas.

In addition, when the IRS releases an angel list or corrective guidance to clarify the tax shelter reporting rules, it reveals publicly the specific activities about which the IRS does not want to receive information. For aggressive types, this guidance may serve as a playbook of the transactions they could purposely disclose in order to distract the IRS. For example, after the IRS announced in 2006 that total return equity swaps were no longer subject to mandatory disclosure requirements, it subsequently reported on its website and in a public notice that "[t]he Service has continued to receive unnecessary disclosures from taxpayers meeting the exceptions [described in the IRS's

222. See *supra* notes 179–184 and accompanying text.

223. See *supra* note 79.

224. Bennett, *supra* note 82, at 15 (quoting Nicholas J. DeNovio, IRS Deputy Chief Counsel). At a similar meeting in 2006, another IRS official commented to the audience, "there are going to be instances where [disclosure] isn't a gray area and it isn't a judgment call, and we would ask that practitioners thoughtfully analyze the situation and come to the appropriate conclusion." Tandon, *supra* note 66, at 203 (quoting Christopher B. Sterner, Division Counsel, IRS Large and Midsize Business Division).

notice].”²²⁵ Though we may not know exactly what motivated the taxpayers and advisors that filed these unnecessary disclosures, some may have been filed by aggressive types as a strategy for hiding abusive tax planning.

IV. CAN OVERDISCLOSURE BE OVERCOME? REFORM POSSIBILITIES

Despite the predictable nature of overdisclosure and the threats it poses to tax administration, neither the substantive tax law nor the IRS has adopted an effective strategy for preventing it.

Several commentators have concluded that overdisclosure is a necessary evil resulting from rules that impose high penalties for failing to disclose information or, alternatively, increase the possibility of the IRS challenging their tax positions if they do disclose.²²⁶ According to this view, overdisclosure is a problem the tax law cannot address preemptively and that the IRS should deal with, as needed, reactively.²²⁷

Yet the IRS's past attempts to reduce overdisclosure have been inadequate. By refusing to implement an overdisclosure policy that taxpayers and advisors can apply on an *ex ante* basis, the IRS has encouraged them to overdisclose by applying the tax shelter reporting rules broadly.²²⁸ When the IRS has eventually issued corrective guidance, often years after the original rules evoked an overdisclosure response, the guidance may not have had its intended effect.²²⁹ And public pleas from IRS officials that taxpayers and advisors not “contort the regs for overdisclosure of routine issues”²³⁰ appear to have often fallen on deaf ears.

Further, the most obvious way to alleviate the overdisclosure response—repeal of the high nondisclosure penalties—would likely cause taxpayers and advisors to revert to the general disclosure behavior they exhibited before 2004—minimal to no disclosure.²³¹

Without the threat of nondisclosure penalties, conservative types would limit their disclosure to tax positions they believe may actually result in an

225. Internal Revenue Service, Explanation of Notice 2006-16—Impact on Required Disclosures (June 5, 2009), <http://www.irs.gov/businesses/article/0,,id=158628,00.html>.

226. See, e.g., Pearlman, *supra* note 4, at 303 (“Do taxpayers really care whether the Service is overburdened? . . . As far as I am concerned, that is the Service’s problem.”).

227. See *id.*

228. See *supra* notes 146–167 and accompanying text.

229. As Part II.B demonstrated, the IRS continues to face the overdisclosure response, despite its attempted preventative measures.

230. See, e.g., Bennett, *supra* note 82, at 15 (quoting Nicholas J. DeNovio, IRS Deputy Chief Counsel).

231. See *supra* note 71 and accompanying text.

IRS challenge on substantive legal grounds. The reason for this change in behavior is that without nondisclosure penalties, the only consequence of failing to disclose a transaction would be the loss of a defense to accuracy penalties. If the IRS were to challenge a nondisclosed tax position and apply an accuracy penalty, the taxpayer would not be able to use disclosure as a way to establish a reasonable cause or good faith defense.²³² Because conservative taxpayers and advisors do not participate in tax planning that they consider likely to generate a challenge from the IRS, they would probably file very few, if any, reportable transaction disclosure statements.

For aggressive taxpayers, the repeal of the nondisclosure penalties would eliminate any incentive to file reportable transaction disclosure statements with the IRS. The primary reason why aggressive taxpayers participate in the mandatory disclosure regime is, as I have argued, to escape the high nondisclosure penalties while continuing to hide their abusive tax shelters.²³³ If the nondisclosure penalties were repealed, an aggressive type would have no motivation to disclose; after all, the best strategy for avoiding IRS detection of an abusive tax shelter is to disclose nothing. And without the overdisclosure culture that conservative types have created due to their extreme caution, an aggressive type would view disclosure as an obvious way to attract scrutiny from the IRS.²³⁴

Rather than advocate a single “silver bullet” solution to a multi-layered problem, I offer three proposals that could be implemented together as an overall strategy to reduce overdisclosure: (a) use anticipatory angel lists when the IRS designates new listed transactions, (b) enact targeted monetary penalties for certain acts of overdisclosure, and (c) require business taxpayers to file copies of certain non-tax documentation describing the disclosed transactions that the taxpayers prepared for actors other than the IRS.

A. Anticipatory Angel Lists

A significant contributing factor to the overdisclosure response is the government’s reluctance to inform taxpayers and advisors explicitly that they should not disclose participation in certain nonabusive activities, especially

232. I.R.C. § 6662(a), (d) (2006) (setting forth reasonable cause as a defense to accuracy penalty equal to 20 percent of the understatement of tax).

233. See *supra* notes 196–210 and accompanying text.

234. Further, without the nondisclosure penalties, the IRS would have little authority under other provisions of the tax law to deter taxpayers and advisors from ignoring the obligation to disclose participation in reportable transactions. See, e.g., *Germantown Trust Co. v. Comm’r*, 309 U.S. 304 (1940) (holding that a wrong form filed was still considered a tax return for purposes of statute of limitations).

in cases involving listed transactions.²³⁵ When the IRS designates a tax strategy as a listed transaction, it generally uses a revenue ruling or notice to focus attention on the details of the tax strategy at issue.²³⁶ To date, the IRS has designated thirty-four separate tax strategies as listed transactions and maintains the original designation announcements on its website.²³⁷ None of these announcements contains specific instructions from the IRS regarding tax strategies that are explicitly exempted from the listed transaction designation.²³⁸

In contrast to its current approach, the IRS could preempt overdisclosure by incorporating angel lists into its listed transaction announcements.

When it designates a tax strategy as a listed transaction, the IRS could also supply taxpayers with a list of similar transactions that are, in the IRS's view, nonabusive. The government has already commented that it may use the transaction-of-interest category as a way to solicit feedback from taxpayers and advisors before announcing a listed transaction.²³⁹ This approach could supply information not only about the abusive tax strategy at issue, but also about nonabusive transactions that a listed transaction notice could unintentionally cover.

Under this proposal, if the IRS eventually designates the tax strategy as a listed transaction, it would include in its announcement an angel list of clearly nonabusive transactions, exempting them from the mandatory disclosure requirements. Each announcement of a new listed transaction could include a section entitled "Transactions Not Substantially Similar" that describes these nonabusive transactions. Because the IRS would include these angel lists in the designation of a listed strategy initially, rather than years later through corrective guidance, the angel lists can be characterized as anticipatory.

1. Rationale

Anticipatory angel lists could enhance the IRS's tax shelter detection efforts by adding more precision to disclosure requests, preempting the uncertainty that typically follows the designation of a new listed transaction, and encouraging cooperation between conservative taxpayers and advisors and the IRS.

235. See *supra* notes 168–169 and accompanying text.

236. See, e.g., I.R.S. Notice 2001-17, 2001-1 C.B. 730.

237. IRS, Recognized Abusive and Listed Transactions (May 28, 2009), <http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html>.

238. See *id.*

239. T.D. 9350, 2007-38 I.R.B. 607, 608 ("IRS and Treasury Department may choose to publish advance notice and request comments").

Focused Disclosure Requests. Because anticipatory angel lists would describe specific, clearly nonabusive transactions that need not be disclosed, they would be unlikely to lead to underdisclosure or nondisclosure in the same manner as other possible exceptions.

In the past, when the IRS publicly described the details of a new listed transaction, it avoided stating that the transaction “fails to serve a significant business purpose other than tax avoidance.”²⁴⁰ The probable rationale for this and similar omissions is that if the IRS were to include them, the scope of the listed transaction designation could effectively be narrowed. Clever taxpayers and advisors, seeking to avoid disclosure, could manufacture a nominal business purpose or find ways to disclaim a tax avoidance plan.

By contrast, anticipatory angel lists could focus the IRS’s listed transaction designation by identifying nonabusive transactions that would not be subject to mandatory disclosure. The IRS has issued similar angel lists for other categories of reportable transactions, such as loss transactions, in anticipation of excessive reporting.²⁴¹ When the IRS announced that taxpayers must disclose transactions that generate significant tax losses, for example, the IRS also announced that if a taxpayer claims a tax-deductible loss due to “fire, storm, shipwreck or other casualty,” it is not required to file a reportable transaction disclosure statement.²⁴² The reason for the disclosure exception here is clear: The IRS considers it unlikely that a taxpayer would purposely incorporate a costly fire or sinking ship into a transaction simply to avoid federal income tax. IRS officials have not reported a decrease in the disclosure of potentially abusive tax strategies as a result of this exemption.²⁴³

Surprisingly, the IRS has failed to provide comparable anticipatory angel lists when designating listed transactions.²⁴⁴ This is particularly odd given that the listed transaction category, unlike loss transactions and confidential transactions, is subject to the extremely broad “substantial similarity” standard.²⁴⁵ As a result, anticipatory angel lists would significantly shift the IRS’s

240. See, e.g., I.R.S. Notice 2008-20, 2008-6 I.R.B. 406 (avoiding use of this language in describing intermediary corporation tax shelters).

241. See, e.g., Rev. Proc. 2004-66, 2004-50 I.R.B. 966; Rev. Proc. 2007-20, 2007-7 I.R.B. 517 (describing certain types of agreements with contractual protection that are not required to be disclosed).

242. Rev. Proc. 2004-66, 2004-50 I.R.B. 966-67 (describing certain types of loss transactions that are not required to be disclosed).

243. *Id.* For an illustration of a similar angel list, see Rev. Proc. 2007-20, 2007-7 I.R.B. 517 (describing certain types of agreements with contractual protection that are not required to be disclosed).

244. See *infra* note 251.

245. See *supra* notes 146–154 and accompanying text. Shortly before this Article was published, the IRS released a revised Notice describing the components of an intermediary corporation tax shelter, I.R.S. Notice 2008-111, 2008-51 I.R.B. 1299. The Notice includes three “safeharbor” transactions that do not qualify as intermediary corporation tax shelters. *Id.* While the Notice is certainly a step in the

approach to designating new listed transactions. If conservative taxpayers and advisors were to adhere to the new anticipatory angel lists, the IRS could increase the speed with which it detects real abuse.

Reduced Corrective Guidance. Anticipatory angel lists may also lessen the amount of corrective guidance the IRS issues to clarify its original designations of listed transactions. As Part III demonstrated, a frequent response to new listed transactions is that taxpayers and advisors immediately disclose nonabusive transactions they deem substantially similar to those described in the announcements.²⁴⁶ The IRS has periodically issued corrective guidance exempting nonabusive transactions from mandatory disclosure, though often years after its original announcement (and in some cases not at all).²⁴⁷ Sometimes the corrective guidance has increased uncertainty among taxpayers and advisors, and has failed to dissuade them from disclosing the nonabusive activities at issue.²⁴⁸ By including anticipatory angel lists in initial designations of listed transactions, the IRS may avoid the need to issue such corrective guidance in the future. As a result, the IRS could prevent years from elapsing after its initial designation of a listed transaction during which taxpayer and advisor confusion over what must be disclosed festers.

Cooperative Approach. A final benefit of anticipatory angel lists is that they may reduce resistance to the government's new disclosure initiatives. Taxpayers and advisors who do not participate in abusive tax planning but nonetheless feel burdened by the tax shelter reporting rules often criticize the IRS's attempts to designate new listed transactions or otherwise expand the scope of the tax shelter reporting rules.²⁴⁹ As a result, the Treasury and IRS often make concessions to appease this constituency, even though these concessions may allow some abusive tax planning to escape detection. By not only seeking comments before designating new listed transactions, but also acting on them through the use of anticipatory angel lists, the IRS could mollify some of the hostility toward the mandatory disclosure regime.²⁵⁰

right direction, it was issued seven years after the IRS's original designation of the intermediary corporation tax shelter as a listed transaction. See I.R.S. Notice 2001-16, 2001-1 C.B. 730.

246. See, e.g., *supra* note 152 and accompanying text.

247. See *supra* note 152 and accompanying text.

248. See *supra* note 152 and accompanying text.

249. For example, when the Treasury announced its intention to create a new category of reportable transactions, "transactions of interest," conservative taxpayers and advisors protested. TAX SECTION, N.Y. STATE BAR ASS'N, *supra* note 63, at 4-9.

250. The proposal would respond to a frequent request from taxpayers and advisors for explanatory guidance. See, e.g., Stratton, *supra* note 119, at 20 (quoting a practitioner at an IRS presentation as commenting, "Feedback on what the IRS doesn't need would be helpful").

2. Potential Objections

The principal potential objections to the use of anticipatory angel lists are that they may provide an incentive for taxpayers and advisors to avoid disclosure, unduly tie the IRS's hands, and inform aggressive types of the transactions that disrupt the IRS's detection efforts. Each of these potential objections is addressed below.

Another Disclosure Loophole. A likely objection to the proposed use of anticipatory angel lists is that it could reduce the willingness of taxpayers and advisors to err on the side of disclosure when considering whether questionable tax strategies are reportable transactions. Dean David Schizer, for instance, has criticized the IRS's use of angel lists in the past, asserting that "taxpayers analogize to transactions on the list in order to conclude that they do not have to disclose transactions that, in light of the purposes of the regime, should be disclosed."²⁵¹

There are two reasons why the disclosure loophole concern does not outweigh the benefits of the proposed use of anticipatory angel lists.

First, if a court or the IRS determined that a taxpayer or advisor had abused the angel list to avoid disclosing participation in a questionable transaction, the taxpayer or advisor would be considered as having failed to disclose participation in a listed transaction. Thus, that taxpayer or advisor would be subject to the most severe penalties in the mandatory disclosure regime.²⁵² The angel lists that Schizer has criticized, by contrast, involved other categories of reportable transactions for which the penalty for nondisclosure is significantly lower.²⁵³ Taxpayers and advisors, even aggressive ones, may thus not be willing to exploit anticipatory angel lists because of the much higher penalties that result from a determination of failure to disclose participation in a listed transaction.

Second, the IRS would presumably craft the angel lists as narrowly as possible, describing included transactions with great specificity and only including clearly nonabusive transactions. Further, no "substantial similarity" standard should apply to the anticipatory angel lists. As a result, taxpayers and advisors would still have to disclose participation in any transactions not exactly like those on the anticipatory angel list. A taxpayer seeking to rely on an angel list as a basis for nondisclosure would, in other words, have to engage in a transaction exactly like one on the list.

251. David M. Schizer, *Enlisting the Tax Bar*, 59 TAX L. REV. 331, 358 n.64 (2006).

252. See I.R.C. § 6707A(b)(2)(B) (2006) (\$200,000 penalty for corporations).

253. See *id.* § 6707A(b)(1)(B) (\$50,000 penalty for corporations).

Tying the IRS's Hands. Another potential objection is that the proposal would effectively tie the IRS's hands by forcing it to commit up-front to a list of exemptions. Opponents of anticipatory angel lists could argue that the IRS does not necessarily know at the time when it designates a tax strategy as a listed transaction what variations of that strategy are abusive or nonabusive.²⁵⁴ It can reach such conclusions only after careful review. The status quo approach, they might argue, provides the IRS with flexibility to determine what changes, if any, it should make to its original designation of a listed transaction.

But anticipatory angel lists would not prevent the IRS from issuing corrective guidance in the future. If the IRS designates a listed transaction and includes an anticipatory angel list, but subsequently determines that a transaction on the angel list really should be disclosed, or, alternatively, determines that a nonabusive transaction should have been included on the angel list, the IRS can simply issue corrective guidance.²⁵⁵ The proposal should limit the need for such corrective guidance, especially considering that the IRS would have consulted with taxpayers and advisors regarding transactions for the angel list before designating a new listed transaction; but the proposal certainly does not prohibit such guidance.

Playbook for Aggressive Types. An important potential objection to the proposed anticipatory angel lists is that they may help aggressive taxpayers and advisors that seek to overdisclose participation in nonabusive transactions as a detection avoidance strategy. As Part III discussed, aggressive types may attempt to hide disclosure of an actual abusive tax strategy by also disclosing transactions very similar to those in the IRS's corrective guidance and angel lists—disclosures that, as the IRS itself has indicated, impede the IRS's detection efforts.²⁵⁶ The IRS's use of anticipatory angel lists, which would describe potentially distracting nonabusive transactions earlier rather than later, thus might offer aggressive types a head start on overdisclosure.²⁵⁷

In order to ameliorate this potentially serious problem while still reducing overdisclosure, the law should contain some disincentive for aggressive taxpayers to disclose participation in transactions that the IRS has included

254. See, e.g., Schizer, *supra* note 251, at 358.

255. See *supra* notes 168–171 and accompanying text.

256. See *supra* note 225 and accompanying text.

257. For example, although I.R.S. Notice 2008-111, 2008-51 I.R.B. 1299, contains three “safeharbor” transactions that do not qualify as intermediary corporation tax shelters, an aggressive type may pursue the overdisclosure strategy by purposely disclosing to the IRS its participation in one of these transactions. See note 245 for a description of IRS Notice 2008-111.

on an anticipatory angel list. The next Subpart describes how such a disincentive for aggressive types might be implemented.

B. Targeted Overdisclosure Penalties

Overdisclosure is not just the product of uncertain features of the tax shelter reporting rules, but also of a significant omission from these rules. It is an act for which the tax shelter reporting rules levy no explicit sanction.²⁵⁸

The absence of any sanction for filing unnecessary disclosure statements with the IRS makes the decision to overdisclose an obvious one for both conservative and aggressive types. For conservative types, when there is a real question over whether a clearly nonabusive transaction is reportable under a broad application of the rules, erring on the side of disclosure is easy. For aggressive types, overdisclosure is even better than costless—it could actually enable them to avoid potentially significant costs that would occur if the IRS detected their abusive tax shelters.

By contrast, current tax law contains severe penalties for taxpayers and advisors that fail to disclose their participation in reportable transactions or that file disclosure statements missing required information.²⁵⁹ By failing to raise red flags for the IRS, taxpayers and advisors that do not disclose undermine the IRS's ability to detect abusive tax planning and collect the proper amount of revenue. The principle underlying the high penalties for nondisclosure, consequently, is to force taxpayers and advisors to internalize these costs. As this Article has demonstrated, overdisclosure can be equally disruptive to the IRS's detection efforts as nondisclosure by providing the IRS with so much information that red flags become very difficult, if not impossible, to identify. Despite this likely harm, the tax law contains no symmetrical monetary penalty for taxpayers and advisors that overdisclose.

Because the delivery of too much irrelevant information to the IRS can have the same adverse consequences as the delivery of too little relevant information, the tax law should impose monetary penalties not only for nondisclosure, but also for overdisclosure.

While the IRS and the tax law have not considered the use of penalties for acts of overdisclosure, other institutions and bodies of law have implemented such penalties.²⁶⁰ As the following discussion illustrates, one simple

258. See I.R.C. § 6707A (containing penalties for nondisclosure, but not overdisclosure).

259. See *supra* notes 179–185 and accompanying text.

260. In the litigation context, for instance, the Federal Rules of Civil Procedure empower judges to force a party to bear the attorney fees and other costs of an opposing party if it engages in dumptruck discovery or here-is-the-warehouse tactics. See FED. R. CIV. P. 37(b) (permitting sanctions

and efficient model for penalizing taxpayers and advisors that report their participation in nonabusive transactions is California's recently enacted monetary penalties for individuals who use the 911 emergency telephone system to report non-emergency events.

1. Non-Emergency 911 Calls

As the federal government has mandated in recent years that wireless telephones have access to the 911 emergency telephone system,²⁶¹ local fire and police stations throughout the U.S. have reported a dramatic increase in calls to 911 that do not relate to real emergencies.²⁶²

In California, for example, of the nearly eight million 911 calls from wireless telephone callers in 2007, approximately 45 percent of those calls did not relate to emergencies.²⁶³ Some of the non-emergency calls, California officials reported, were from callers with real problems, but who should have sought help elsewhere, such as an individual seeking assistance regarding his email address or a landlord asking police to serve an eviction notice.²⁶⁴ Other non-emergency calls originated with prank callers, such as individuals who dialed 911 to complain about late delivery of recently ordered pizza or to inquire about the upcoming week's weather report.²⁶⁵ According to California officials, as a result of the increased volume, more than one third of calls can go unanswered during high volume times.²⁶⁶

In 2008, the California legislature responded to this situation by enacting high penalties for individuals who use, or for parents of minors who allow the use of, the 911 telephone system "for any reason other than because of an emergency," which is defined as "any condition in which emergency services will result in the saving of a life, a reduction in the destruction of property, or

for failure to cooperate with discovery requests). See *infra* notes 279–280 and accompanying text for additional examples.

261. See Federal Communications Commission, *Wireless 911 Services*, <http://www.fcc.gov/cgb/consumerfacts/wireless911srcv.html> (last visited June 9, 2009) (describing 911 requirements for wireless telephone service providers).

262. See Alex Johnson, *911 Systems Choking on Non-Emergency Calls: Pranksters, Clueless Callers Block Lines for Legitimate Crises*, MSNBC.COM, Aug. 5, 2008, <http://www.msnbc.msn.com/id/26040857> (describing the nationwide overload of frivolous 911 calls from "pranksters" and "clueless callers").

263. *Id.* (quoting a California Highway Patrol official).

264. See *Bigger Penalties for Frivolous 911 Calls Signed Into Law*, KESQ.com, July 12, 2008, <http://www.kesq.com/Global/story.asp?S=8664998> [hereinafter *Frivolous 911 Calls*].

265. See *id.*

266. See *id.* ("During times when call volume is high, . . . more than a third of cell phone calls made to the California Highway Patrol—the agency to which all such calls are initially routed—go unanswered, making frivolous phone calls all the more disruptive.").

quicker apprehension of criminals,” among other specifically described events.²⁶⁷ Under California’s new penalty structure, an individual receives an initial warning for the first non-emergency call, a \$50 penalty for the second call, a \$100 penalty for the third, and a \$250 penalty for all future non-emergency calls.²⁶⁸

Proponents of the California legislation have argued that it will cause the type of individuals who have placed frivolous 911 calls in the past—either out of ignorance or bad intent—to refrain from placing such calls after considering the potential penalties.²⁶⁹ According to the bill’s author, the new penalties are intended to “better deter this dangerous behavior by more immediately imposing significant sanctions upon illegal callers.”²⁷⁰

2. Application to Tax Shelter Disclosure

Just as frivolous 911 calls impede the ability of emergency service providers to deliver life-saving aid,²⁷¹ overdisclosure causes IRS agents to spend considerable time investigating highly complex nonabusive transactions rather than those involving abusive tax planning. And just as 911 operators receive calls from two types of individuals, the ignorant and the malicious, the IRS receives unnecessary disclosure from both conservative and aggressive types.²⁷² In light of these similarities, the government might fine taxpayers or advisors that disclose nonabusive activities in the same way that California imposes escalating penalties for non-emergency 911 calls.

Despite the common traits of the two types of unhelpful reporting, there is a significant difference that may reduce the feasibility of monetary penalties for overdisclosure. Most individuals can quickly determine whether an event is a real emergency before placing a call to 911. Taxpayers and advisors, on the other hand, may not be able to determine as easily whether a transaction qualifies as potentially abusive under the tax shelter reporting rules.

This distinction begs caution in imposing fines like those for frivolous 911 calls on taxpayers and advisors that overdisclose nonabusive activities. Because the IRS cannot identify an abusive tax shelter without seeing it, requests for information from taxpayers and advisors must contain some level

267. Assemb. B. 1976, 2007–2008 Leg., Reg. Sess. (Cal. 2008).

268. *Id.*

269. *Frivolous 911 Calls*, *supra* note 264.

270. Bill Analysis, Assemb. B. 1976, 2007–2008 Leg., Reg. Sess. (Cal. June 11, 2008), available at http://www.leginfo.ca.gov/pub/07-08/bill/asm/ab_1951-2000/ab_1976_cfa_20080611_123529_sen_floor.html.

271. As one 911 operator described the problem, “You’ve got a true emergency with somebody out there—that there’s a shooting or something—then those officers are not able to respond to that emergency call, because they’re taking care of callers who abuse 911. . . .” Johnson, *supra* note 262.

272. See *supra* Part III.

of generality. A monetary penalty for overdisclosure, especially when combined with the existing high penalties for nondisclosure,²⁷³ could understandably increase taxpayer and advisor confusion.

A response to this potential design obstacle could be to limit penalties to taxpayers and advisors that disclose the most obviously nonabusive transactions—those that the IRS has explicitly included on an angel list.

Because the transactions on an angel list are nonabusive and clearly described, they would provide adequate advance notice of disclosure that could subject taxpayers and advisors to overdisclosure penalties. As the previous Subpart discussed, the IRS aims to keep angel lists as specific as possible, to avoid creating loopholes through which taxpayers or advisors could avoid disclosing information that is relevant to tax shelter detection.²⁷⁴

Of course, the angel lists would not alleviate all uncertainty, and a monetary penalty for overdisclosure should not apply if a taxpayer or advisor was honestly unsure whether a particular transaction was exactly like one on the angel list. To deal with this situation, an exception could apply to any taxpayer or advisor who received a private letter ruling²⁷⁵ from the IRS allowing disclosure.

In summary, under this proposal, any taxpayer or advisor that discloses a transaction included on an IRS angel list would be subject to a monetary penalty for each disclosure, unless the taxpayer or advisor has sought and received a private letter ruling from the IRS permitting disclosure of the transaction at issue. This proposed penalty for acts of overdisclosure would apply on a strict liability basis. It would supplement, not replace, those penalties that apply under current law for acts of nondisclosure.

3. Rationale

The proposed penalty would better deter aggressive types from overdisclosing than current law, would cause conservative types to increase their care when filing disclosure statements, and would be a more administrable approach to the overdisclosure response than other alternatives.

Increased Deterrence. While the proposed penalty would not apply to all forms of overdisclosure, it would increase the cost of burying information about an abusive tax position amid a sea of disclosure statements regarding

273. See I.R.C. § 6707A (2006).

274. See *supra* notes 235–239 and accompanying text for discussion of angel lists.

275. A private letter ruling is a written determination from the IRS regarding the expected tax treatment of a particular transaction. See Rev. Proc. 2008-1, 2008-1 I.R.B. 1, 6 (describing purpose of private letter rulings).

specifically designated nonabusive transactions. The aggressive hedge fund that continues to file disclosure statements regarding plain vanilla total return swaps, as a way to hide its notional principal contract tax shelter,²⁷⁶ would now face a potential monetary penalty for each instance of disclosing an angel list transaction. Further, because the proposed penalty would apply separately to each occurrence of overdisclosure, it would be most effective against aggressive taxpayers and advisors. Aggressive types may calculate the new potential cost of overdisclosure and determine that it is no longer a practical detection avoidance strategy. As a result, the proposed penalty could enhance the IRS's ability to detect and challenge abusive tax planning.

Increased Care. As well as deterring intentional excessive reporting of nonabusive transactions, the proposed penalty would cause conservative taxpayers and advisors to take more care in filing disclosure statements. Just as California's new penalty structure causes residents to consider whether a particular event is a real emergency before dialing 911, the proposed penalty would motivate conservative types to check an IRS angel list before disclosing a particular nonabusive transaction. The proposed penalty, thus, would also enhance the IRS's detection efforts by forcing conservative taxpayers and advisors to internalize the cost of unreasonable caution in complying with the tax shelter reporting rules.

Administrability. The administrability of the proposed penalty, especially when compared with alternative penalty structures, is one of its most attractive attributes.

The proposed penalty is simple. In the same way that California's penalty applies to each non-emergency 911 call,²⁷⁷ the proposed penalty would apply to each disclosure of a nonabusive transaction contained on an IRS angel list. Like California's penalty,²⁷⁸ the proposed penalty applies on a strict liability basis, and thus does not require an inquiry into the intent of taxpayers or advisors filing unnecessary disclosure statements or other factual matters.

The proposed penalty would be much easier to administer than the broad anti-abuse standards other areas of the law have applied in comparable situations. In securities fraud cases, courts have applied the "doctrine of buried facts" where corporations have publicly disclosed material facts in a manner

276. See Kosnitzky, *supra* note 93, at 817–18 (describing the requirement that hedge funds and material advisors disclose possible reportable transactions in protective filings in order to avoid stiff penalties).

277. Assemb. B. 1976, 2007–2008 Leg., Reg. Sess. (Cal. 2008).

278. *Id.*

that obscures their significance.²⁷⁹ For example, when a corporation discloses a director's conflict of interest in a lengthy public filing amid unrelated text, a court may not find this disclosure adequate to shield the corporation from liability to investors. Because the doctrine of buried facts requires heavy factual analysis and is "not logically susceptible to [a] bright line test,"²⁸⁰ it would be a difficult approach to apply in the context of tax shelter reporting. The IRS and the courts would need to consider issues such as the number of nonabusive transactions a taxpayer disclosed at the same time it disclosed an abusive one, as well as the content of the disclosure statements, before determining whether disclosure of the abusive transaction should be disregarded for purposes of the nondisclosure penalties. The proposed penalty negates the need for any similarly fact-intensive inquiries.

Advantages Over "Self-Adjusting Penalty." The proposed penalty is also a more appropriate approach to overdisclosure than Raskolnikov's "self-adjusting penalty."²⁸¹ As an illustration of Raskolnikov's penalty structure, a taxpayer that reports an illegitimate charitable deduction on the same line on its tax return as a large number of legitimate charitable deductions would be subject to a monetary penalty that is based not on the value of the fraudulent deduction, but rather on the value of the legitimate deductions.²⁸² Raskolnikov's penalty applies only when a taxpayer has claimed both a legitimate and an illegitimate tax benefit.²⁸³

As this Article has demonstrated,²⁸⁴ however, disclosure statements that describe solely nonabusive transactions can still weaken the IRS's ability to detect abuse. When an overly cautious taxpayer discloses a transaction that is plain vanilla yet complex, IRS agents may spend significant time and resources reviewing the details of the transaction. If we attempted to apply Raskolnikov's self-adjusting penalty in this scenario, it would not apply to the conservative taxpayer since he has only disclosed information to the IRS regarding nonabusive transactions.

279. See, e.g., *Gould v. Am.-Hawaiian S.S. Co.*, 535 F.2d 761, 778 (3rd Cir. 1976) (disclosure of material facts in footnotes and appendices considered nondisclosure); *Kohn v. Am. Metal Climax, Inc.*, 458 F.2d 255, 290-91 (3rd Cir. 1972) (material facts cannot be "buried" in explanatory materials).

280. *TCG Sec., Inc. v. S. Union Co.*, No. 11282, 1990 Del. Ch. LEXIS 12, at *18 (Del. Ch. Jan. 31, 1990) ("Whether information is 'buried' is the type of determination not logically susceptible to the bright line test that [plaintiff] attempts to create.").

281. Raskolnikov, *supra* note 13.

282. *Id.* at 572.

283. *Id.*

284. See *supra* Part II.C.

The proposed overdisclosure penalty could apply to this scenario. It applies to any disclosure of a nonabusive transaction on an IRS angel list, on a strict liability basis, regardless of the other types of transactions that a taxpayer has disclosed. So in this context, the proposal has a much broader reach than Raskolnikov's self-adjusting penalty.

4. Potential Objections

Likely objections to penalizing overdisclosure are that it could result in time-consuming penalty disputes between taxpayers and the IRS, send mixed signals to taxpayers and advisors regarding what they are required to disclose, and shift the current overdisclosure response to a different medium. Structural features of the proposed penalty, however, should adequately address these concerns.

Penalty Disputes. The first likely objection to a monetary penalty for overdisclosure is that it could encourage litigation over the penalty. Such disputes, opponents might argue, would distract the IRS from focusing on details of the underlying abusive transactions. Daniel Shaviro has written that monetary penalties for taxpayers that disclose too much unhelpful information would "prove too much of a distracting and costly detour from litigating issues of substance."²⁸⁵

While this may be a valid criticism of a penalty for any disclosure of transactions that ultimately are not abusive tax shelters, it is much less compelling in the case of the proposed penalty. Because the proposed penalty applies only to taxpayers and advisors that disclose transactions precisely contained on IRS angel lists, disputes over whether the penalty applies should be minimal.

Mixed Signals. Another potential criticism is that the combination of penalties for failure to disclose, and penalties for overdisclosure, may leave taxpayers and advisors scratching their heads in uncertainty over what information they are required to disclose to the IRS.

Again, the structure of the proposed penalty should alleviate this concern. If the proposed penalty were implemented, taxpayers and advisors would err on the side of disclosure, as they are instructed to do under current law. Before filing a disclosure statement they would simply need to confirm that it does not relate to a transaction explicitly exempted from disclosure by an angel list. The anticipatory angel lists proposed above should, thus, reduce potential taxpayer and advisor uncertainty.

285. Shaviro, *supra* note 67, at 30.

Shifted Overdisclosure. The last likely objection to the proposed penalty is that it would merely shift the overdisclosure response to a different medium. Opponents might argue that the exception from the proposed penalty, for disclosures covered by a private letter ruling, may simply cause taxpayers and advisors to flood the IRS with requests for private letter rulings.

This objection is misguided because it ignores important features of the private letter ruling process. First, private letter ruling requests involve considerable transaction costs, including the fees charged by the IRS and, more significantly, by counsel, and expenses related to the taxpayer's back-and-forth discussions with the IRS.²⁸⁶ It is unlikely that aggressive taxpayers would ignore the potentially onerous costs of requesting private letter rulings for a mere attempt to distract the IRS from their abusive tax strategies. Second, requests for private letter rulings are not addressed by the Office of Tax Shelter Analysis.²⁸⁷ As such, it is unlikely that excessive private letter ruling requests would interfere with the detection efforts of the Office of Tax Shelter Analysis.

C. Non-Tax Documentation

The last proposal I offer to reduce overdisclosure is a reconsideration of the type of information that taxpayers are required to disclose to the IRS.

The IRS currently mandates that taxpayers filing reportable transaction disclosure statements also provide written descriptions of the disclosed transactions.²⁸⁸ An inherent weakness in this disclosure model is that the content of this description is in the total control of the taxpayer. Conservative types may submit pages of detailed and thorough discussion in order to convince the IRS that their disclosed transactions are not abusive, while aggressive types may do the same in order to obfuscate the true tax avoidance purpose of their transactions. The length and complexity of these submissions may slow the IRS's detection capability.²⁸⁹

A contrasting disclosure model could require taxpayers to provide the IRS with non-tax documentation, such as written descriptions of the transaction that the taxpayer prepared for actors other than the IRS.

The IRS has implemented this approach in other contexts, such as private letter ruling requests. When a taxpayer requests a private letter ruling,

286. See Rev. Proc. 2008-1, 2008-1 I.R.B. 1, 16–28, 68 (describing requirements for private letter ruling request, including payment of \$11,500 user fee).

287. See *id.* at 6.

288. I.R.S. Form 8886, l. 7b, *supra* note 120; see also Instructions for I.R.S. Form 8886, *supra* note 112, at 6 (“Describe each step of the transaction including all information known to you.”).

289. See *supra* notes 120–127 and accompanying text.

the IRS requires a detailed description of the transaction and the taxpayer's opinion of how the tax law should apply to it.²⁹⁰ For some transactions, the IRS also requires copies of particular documents the taxpayer wrote for purposes other than tax compliance, such as descriptions of the transaction prepared for its board of directors.²⁹¹ The IRS reviews the non-tax documentation to confirm that the taxpayer has not misrepresented the true motivation underlying its transaction.²⁹²

The non-tax documentation approach could be incorporated into the tax shelter reporting rules, though its scope would need to be limited in the interest of administrability. Since individual taxpayers may not regularly prepare written descriptions of their transactions for non-tax-related purposes, it may be unproductive to apply this requirement to them. Business taxpayers, such as corporations and partnerships, are the type of taxpayers most likely to produce and maintain non-tax documentation. And because the goal of this model is to equip the IRS with transaction descriptions written for a non-tax audience, this disclosure requirement should not apply to documents written for internal tax-compliance staff.

One practical formulation of this approach would be a requirement that when a corporation or partnership files a reportable transaction disclosure statement with the IRS, it must also attach any written description of the transaction that the taxpayer prepared for its chief executive officer, board of directors, shareholders, or partners, prior to filing the disclosure statement.

1. Rationale

The non-tax documentation approach could provide the IRS with an important sorting mechanism that would enhance its ability to detect abuse, dissuade business taxpayers from filing unnecessary disclosure statements, and would be difficult for business taxpayers to avoid.

290. See Rev. Proc. 2008-1, 2008-1 I.R.B. 1, 16-28 for detailed discussion of procedures related to taxpayer submission of private letter ruling requests.

291. The IRS applies this requirement when taxpayers request private letter rulings regarding the applicability of Section 355 of the Internal Revenue Code, a provision that enables a corporation and its shareholders to avoid current tax liability on the distribution of stock of a controlled subsidiary. See Rev. Proc. 96-30, 1996-1 C.B. 696.

292. For example, a corporate taxpayer may represent in its written submission to the IRS that it will not have any continuing relationship with a subsidiary corporation from which it plans to separate in a tax-deferred "spin-off" transaction (a requirement under the tax law), but it may have described the extent of the relationship differently in a written summary for the board of directors.

Sorting Mechanism. A central rationale of this proposal is that, at least with respect to business taxpayers, it could better enable the IRS to sort transactions that deserve continued examination from those that do not.

Non-tax documentation could equip the IRS with descriptions of the disclosed transactions that are more clear and concise than the written descriptions prepared especially for the IRS. Average board members and chief executive officers are unlikely to be fluent in the language of tax law. They are also busy people who must digest significant amounts of written information daily. When a tax director explains a transaction in a memorandum for a large corporation's chief executive officer, she may provide a bullet point discussion in layman's terms of the purpose and potential tax consequences of the transaction. The clarity and brevity of non-tax documentation may enable the IRS to distinguish more quickly an ordinary business transaction from an abusive tax avoidance strategy.

It is also possible that non-tax documentation could provide the IRS with a more thorough explanation of how the taxpayer originally learned of the disclosed transaction. Correspondence between a tax director and senior management may explain a relationship with an advisor in more detail than the current reportable transaction disclosure statement.²⁹³ If such correspondence reveals the participation of a known tax shelter promoter, the IRS would immediately flag the disclosed transaction for further review.

Overdisclosure Friction. Another benefit of this proposal is that it could cause some tax directors to pause before disclosing transactions that are clearly outside of the scope of the reportable transaction categories. Tax directors could perceive the submission of board presentations or written communications to the chief executive officer regarding a nonabusive transaction as risking unnecessary scrutiny by IRS agents. Increased exposure to inquiry by the IRS could especially discourage conservative tax directors from filing unnecessary disclosure statements. A non-tax documentation requirement, thus, could curb the tendency of some taxpayers to view overdisclosure as the default response.

Difficult to Avoid. An attractive feature of the proposal is that it may be difficult for business taxpayers to avoid creating a paper trail regarding tax strategies they eventually must disclose to the IRS. The IRS often designates specific transactions as subject to mandatory disclosure after significant numbers

293. The current form on which a taxpayer discloses a reportable transaction asks only for the name and address of any individual or entity to which it paid a fee for tax advice regarding the transaction. The form does not require the taxpayer to describe the nature of its relationship with this individual or entity. I.R.S. Form 8886, l. 6, *supra* note 120.

of taxpayers have used them to claim tax benefits.²⁹⁴ The consequence of retroactive disclosure requirements is that a written presentation regarding a now reportable transaction may have been prepared before the IRS designated the transaction as one that must be disclosed. If the IRS subsequently designated it as a listed transaction or a transaction of interest, the business taxpayer would have to attach copies of the presentation to its reportable transaction disclosure statement. Deliberate noncompliance or fraud would be the only ways this business taxpayer could avoid the non-tax documentation requirement.

2. Potential Objections

Opponents of the non-tax documentation approach would likely argue that it would increase the IRS's administrative burden, suffer from noncompliance, and force business taxpayers to provide the IRS with legally privileged information. Each of these arguments is considered below.

Increased Administrative Burden. A probable objection to the non-tax documentation requirement is that it could bury the Office of Tax Shelter Analysis in additional paper, extending the amount of time it takes for IRS agents to identify disclosure statements that reveal questionable transactions.

This objection overlooks unique ways in which the IRS could utilize the non-tax documents, compared to what it currently receives. The IRS could specifically search for deviations between a business taxpayer's description of a transaction in its disclosure statement and its characterization of the same transaction to its chief executive officer or board of directors. One team of IRS agents could review business taxpayers' written submissions in their disclosure statements and a different team could review non-tax documentation. The two teams could compare notes and identify inconsistencies. Strong deviations may prompt the IRS to give a disclosed reportable transaction further review.

If the non-tax documentation requirement created an administrative burden on the IRS, or business taxpayers, its scope could be narrowed. For example, the proposal could apply to non-tax documents produced during a fixed time period, such as one to two years prior to the business taxpayer's submission of its disclosure statement. Another modification could restrict the requirement to business taxpayers with net assets in excess of a set threshold.

High Noncompliance Risk. Another likely objection is that business taxpayers could respond to the new requirement by filing disclosure statements that omit incriminating documents, or by simply failing to disclose any additional documents at all.

294. See *supra* notes 162–163 and accompanying text.

Such noncompliance concerns, however, neglect key incentives that business taxpayers may have to file non-tax documentation with the IRS. Failure to file the required non-tax documentation would incur high monetary and other penalties under existing law.²⁹⁵ Just as high monetary penalties for nondisclosure have encouraged business taxpayers to increase their filing of disclosure statements,²⁹⁶ such penalties should also create a powerful incentive for business taxpayers to attach non-tax documentation. Further, conservative tax directors may comply out of fear that a reportable transaction disclosure statement containing minimal non-tax documentation could raise a new red flag for the IRS and, consequently, invite unwelcome audit attention.

Privileged Information. Opponents of this proposal could also argue that it would force business taxpayers to submit documents that are legally privileged under the attorney-client privilege, statutory confidentiality protections,²⁹⁷ or the work product doctrine.

Although such privilege claims have salience in other contexts,²⁹⁸ they should be significantly less relevant if the IRS were to implement the non-tax documentation proposal. First, because the proposal would apply to documentation prepared solely by the taxpayer, neither the attorney-client privilege nor the statutory confidentiality protections for advice from authorized tax practitioners²⁹⁹ should apply. Second, the work product doctrine only applies to documents that were prepared “in anticipation of litigation or for trial.”³⁰⁰ While some courts have held that taxpayers may prepare tax accrual work papers in anticipation of litigation,³⁰¹ this proposal targets documents that business taxpayers prepare for a different purpose: to seek necessary approval to engage in a particular transaction. It is unlikely, therefore, that business taxpayers could argue successfully that they prepared these documents as a result of a “substantial threat”³⁰² of litigation.

295. For a description of these penalties, see *supra* notes 179–195 and accompanying text.

296. See *supra* notes 179–195 and accompanying text.

297. See I.R.C. § 7525 (2006) (“Confidentiality Privileges Relating to Taxpayer Communications”).

298. See *U.S. v. Textron Inc.*, 507 F. Supp. 2d 138, 141, 155 (D.R.I. 2007) (denying the government’s request for taxpayer accrual work papers), *aff’d in part and vacated in part on other grounds*, 553 F.3d 87, 106 (1st Cir. 2009). But see Dennis J. Ventry, Jr., *Protecting Abusive Tax Avoidance*, 120 TAX NOTES 857 (2008) (criticizing the *Textron* decision).

299. I.R.C. § 7525.

300. FED. R. CIV. P. 26(b)(3).

301. *Textron*, 507 F. Supp. 2d at 149–51.

302. *SmithKline Beecham Corp. v. Apotex Corp.*, 232 F.R.D. 467, 484 (E.D. Pa. 2005).

CONCLUSION

This Article has argued that the government should not only deter nondisclosure of information required by the tax shelter reporting rules, but should strive to prevent overdisclosure of information as well. Congress acted appropriately in 2004 by enacting severe penalties for taxpayers and advisors who simply turn their backs on the obligation to disclose reportable transactions. But by ignoring the potential for overdisclosure, the government has allowed proverbial haystacks of unnecessary disclosure statements to accumulate and shield tax shelter needles from view.

The tax law, as this Article has demonstrated, offers multiple incentives for conservative and aggressive taxpayers and advisors to embrace overdisclosure. Conservative types, who exhibit caution and prudence as core attributes, respond to broad and uncertain reporting requirements by erring on the side of disclosure rather than risk any chance of high nondisclosure penalties. And aggressive types, who rationally consider expected benefits and costs of risky tax positions, view excessive disclosure as a perfectly legal way to escape the high nondisclosure penalties while obscuring their use of abusive tax strategies.

As an alternative to the government's wait-and-see approach to overdisclosure, this Article has offered three proposals that could be implemented as an overall preemptive strategy. First, to prevent disclosure of clearly nonabusive activities, the IRS should include them on anticipatory angel lists when designating new listed transactions. Next, as a means of explicitly deterring the overdisclosure response, Congress should enact targeted monetary penalties for taxpayers and advisors who report participation in any transaction on an IRS angel list. Last, to enhance the IRS's ability to sort abusive transactions from nonabusive ones and to discourage overdisclosure, the IRS should require business taxpayers to submit copies of non-tax documentation when filing reportable transaction disclosure statements.

While some have praised the mandatory disclosure regime for winning the war on tax shelters,³⁰³ too much information can have the same value as too little. Unless the government recognizes this reality and reacts accordingly, the tax shelter victory may prove to be short-lived.

303. Olson, *supra* note 5, at 567–70.