COMMENT

Understanding the Statutory Tax Practitioner Privilege: What Is Tax Shelter "Promotion"?

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The Internal Revenue Service (IRS) is given the broad authority to conduct investigations, file suit, and request documents from taxpayers when necessary to enforce the provisions of the Internal Revenue Code.[1] The IRS can seek to acquire written communications between a taxpayer and his tax adviser.[2] Such documents may include tax opinions and tax planning memoranda.[3] Taxpayers represented by lawyers are able to protect some of these communications through the common law attorney–client privilege.[4] Certain nonlawyers are also authorized to represent taxpayers before the IRS and to give tax planning advice, but their communications fall outside the scope of the attorney–client privilege. This group includes accountants, enrolled agents, and enrolled actuaries.[5]

In 1998, Congress created the tax practitioner–client privilege,[6] which extended the protections of the attorney–client privilege to certain communications between nonlawyer tax practitioners and their clients.[7] This statutory privilege, however, carves out an exception—it does not apply to written communications related to the "promotion" of a client's participation in a tax shelter.[8]

Recently, a disagreement has arisen regarding the scope of this exception and the meaning of the word "promotion." In *Countryside*

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1 See IRC § 7602.

2 Ronald E. Friedman and Dan L. Mendelson, *The Need for CPA–Client Privilege in Federal Tax Matters*, 27 Tax Adviser 154, 154 (1996).

3 See id at 155.

4 See *Upjohn v United States*, 449 US 383, 387–88, 396 (1981) (applying this "oldest of the [common law] privileges for confidential communications" to hold that a corporation can withhold from the IRS documents generated by its general counsel).

5 31 CFR § 10.3.

6 Internal Revenue Service Restructuring and Reform Act of 1998 § 3411, Pub L No 105-206, 112 Stat 685, 750, codified at IRC § 7525.

7 See IRC § 7525(a).

8 IRC § 7525(b).

Limited Partnership v Commissioner of Internal Revenue,[9] the Tax Court relied on legislative history to hold that tax advice given as part of a close and routine relationship was not promotion and therefore survived the tax shelter exception.[10] But in *Valero Energy Corp v United States*,[11] the Seventh Circuit rejected legislative history arguments and held that promotion *can* include advice given by a taxpayer's "long-time advisors."[12]

How broadly courts define promotion for the purpose of the tax shelter exception has a major impact on the usefulness of the privilege.[13] The statute uses a vague and potentially overbroad definition for "tax shelter" found in IRC § 6662(d), further placing the scope of the exception in question.[14] A primary goal of professional–client privileges is to encourage individuals to be candid with their advisers,[15] but this goal will not be achieved unless courts apply the privilege predictably.[16] Because such a large portion of tax planning is done by accountants,[17] resolution of this disagreement will bring much-needed stability.

This Comment proposes a resolution to the disagreement. Part I provides necessary background information, including an overview of tax shelters, followed by an examination of IRC § 7525 and its legislative history. Part II discusses the case law and the disagreement over the meaning of promotion. Part III sets forth a solution to the

9 132 Tax Ct 347 (2009).

10 Id at 353–55, quoting Internal Revenue Service Restructuring and Reform Act of 1998 Conference Report, HR Rep No 105-599, 105th Cong, 2d Sess 269 (1998).

11 569 F3d 626 (7th Cir 2009).

12 Id at 628, 632.

13 A survey of more than one thousand tax practitioners found that 43 percent of tax professionals agree that "the scope of the privilege is greatly limited" by the tax shelter exception and would apply infrequently. Christine C. Bauman and Anna C. Fowler, *The Expanded Taxpayer Confidentiality Privilege: A Review and Assessment of IRC Section 7525*, 14 Adv Tax 37, 50 (2002). Over 80 percent of the tax professionals did not agree that the privilege has "enhanced" the ability of professionals to "grow" their practices by "leveling the playing field." Id.

14 See IRC § 6662(d).

15 See *Upjohn*, 449 US at 389.

16 See id at 393 ("An uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all."); John Gergacz, *Using the Attorney–Client Privilege as a Guide for Interpreting I.R.C. § 7525*, 6 Houston Bus & Tax L J 240, 241 (2006) (arguing that uncertainty in the applicability of the privilege "means that one must [ ] assume that everything disclosed may later be revealed").

17 Consider Edward L. Maydew and Douglas A. Shackelford, *The Changing Role of Auditors in Corporate Tax Planning* *28 (NBER Working Paper No 11504, June 2005), online at http://www.nber.org/papers/w11504 (visited Jan 24, 2011). For the average S&P 500 company, auditing firms performed $2.5 million worth of tax services in 2003. Id at *19. Much of this work would have been done by CPAs. Consider Alyson Petroni, Note, *Unpacking the Accountant–Client Privilege under I.R.C. Section 7525*, 18 Va Tax Rev 843, 847 (1999).

disagreement, first criticizing the Tax Court's reasoning then using accepted rules of statutory construction to demonstrate that promotion should be interpreted broadly to mean "furtherance" or "encouragement" and should not depend on the length or quality of an advising relationship. Part III then examines the § 6662(d) definition of tax shelter and shows that a broad definition of promotion will not result in the exception swallowing the privilege or interfering with routine and customized tax planning, because courts should limit the meaning of tax shelter in light of previously overlooked Treasury regulations.

I. Background: The § 7525(b) Tax Shelter Exception

A. Tax Planning and Tax Shelters

There is no single definition for tax shelter. One dictionary defines a tax shelter generally as "a strategy, investment, or tax code provision that reduces tax liability,"[18] but the Code employs a specific definition.[19] Taxpayers are generally free to structure their transactions in ways that reduce their tax liability.[20] Consequently, the term "tax shelter" has been applied both to legitimate attempts to reduce one's tax burden and to abusive tax planning techniques that manipulate the Code.[21] For purposes of this background section, tax shelter will refer to any attempt to reduce one's tax burden. Abusive planning practices will be referred to as either "abusive tax shelters" or "abusive tax planning."

It is important to understand some of the basic differences between abusive and legitimate tax planning. Legitimate tax planning generally consists of tax-conscious decisions that are consistent with the Code and congressional intent. Abusive tax shelters, on the other hand, typically seek to exploit the literal language of the Code and realize tax savings in ways not envisioned by Congress.[22] They are highly complex transactions that would not be entered into for any

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18 *Merriam-Webster's Collegiate Dictionary* 1281 (Merriam-Webster 11th ed 2009).

19 See text accompanying notes 68–69.

20 See *Helvering v Gregory*, 69 F2d 809, 810 (2d Cir 1934) (explaining that "there is not even a patriotic duty to increase one's taxes").

21 See Donald L. Korb, *Shelters, Schemes, and Abusive Transactions: Why Today's Thoughtful U.S. Tax Advisors Should Tell Their Clients to "Just Say No,"* 851 PLI/Tax 859, 863 (2008) ("Tax shelters can be grouped into three broad categories: legitimate tax shelters, gray area tax shelters, and abusive tax shelters.").

22 See id.

reason other than their tax benefits.[23] Abusive shelters often involve little to no risk of economic loss and little to no possibility of profit.[24]

Abusive tax shelters can be created by long-term advisers who develop customized plans, or they can be prepackaged and mass marketed. Customized tax planning (whether legitimate or abusive) typically involves an adviser who knows his client's business well and can give advice that is particular to the firm. This might include advice on how to structure various transactions and compensation agreements, or it might include advice on performing abusive transactions to reduce the client's tax liability in a way not intended by Congress.[25] Individualized tax planning can be highly abusive and exploit the same inconsistencies as the selling of mass-marketed tax shelters.[26]

A mass market for prepackaged abusive tax shelters began to thrive in the 1990s.[27] This market was led by the major accounting firms,[28] so an understanding of this type of shelter peddling is important to understanding Congress's motivation behind the tax shelter exception. The accounting firms' power over this market was driven by their massive client bases and global connections. Once a tax shelter was created, it was replicated and sold in nearly identical form to hundreds or thousands of corporate clients.[29] Due to the large volume of sales and diminishing average costs, firms marketing these shelters realized tremendous profits.[30]

A study conducted by the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs detailed

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23 For typical examples of abusive tax shelters, see IRS, *Listed Transactions—LB&I Tier I Issues* (Nov 2010), online at http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html (visited Jan 26, 2011). Many of the listed transactions are illegal, and all must be reported on the participant's tax return. Treas Reg § 1.6011-4(b).

24 See Karen C. Burke and Grayson M.P. McCouch, *COBRA Strikes Back: Anatomy of a Tax Shelter*, 62 Tax Law 59, 65 (2009).

25 See Linda M. Beale, *Tax Advice before the Return: The Case for Raising Standards and Denying Evidentiary Privileges*, 25 Va Tax Rev 583, 596–97 (2006).

26 See id.

27 For a more extensive discussion of some of the causes of the rise of the corporate tax shelter mass market, see Department of the Treasury, *The Problem of Corporate Tax Shelters: Discussion, Analysis and Legislative Proposals* 25–33 (July 1999), online at http://www.treasury.gov/resource-center/tax-policy/Documents/ctswhite.pdf (visited Jan 25, 2011).

28 Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 Yale J Reg 77, 88–92 (2006) (explaining how the accounting industry's "bureaucratic structure, global reach, and enormous client base" enabled the large accounting firms to take the lead in promoting corporate tax shelters). See also U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals—Four KPMG Case Studies: FLIP, OPIS, BLIPS, and SC2, S Prt No 108-34, 108th Cong, 1st Sess 21–22 (2003).

29 See S Prt No 108-34 at 53 (cited in note 28).

30 From 1997 to 2001, revenue from tax services in the United States grew 20 percent per year. See Rostain, 23 Yale J Reg at 91 (cited in note 28).

these shelter-marketing practices during the late 1990s and early 2000s.[31] The report explains the strategies and business plans of several accounting firms. KPMG, for example, had an entire department, the Tax Innovation Center, that was staffed by about a dozen professionals whose "sole mission [was] to push the development of new KPMG tax products."[32] The Center maintained a "Tax Services Idea Bank" that collected ideas for generic strategies.[33] When promising ideas were identified, the Center oversaw their development and marketing.[34] The end product would be a generic plan that could be implemented by almost any taxpayer. KPMG would then cold-call thousands of potential buyers and pitch them the latest tax strategy.[35] The report explains that abusive shelters were also marketed by PricewaterhouseCoopers and Ernst & Young.[36] By targeting taxpayers with large gains to offset and by contacting such a large number of taxpayers, the firms were highly successful in their efforts. One commentator estimated that this massive selling of abusive shelters was reducing tax revenues by billions per year.[37]

Congress has passed a number of rules designed to increase tax shelter detection,[38] as well as rules designed to penalize those who participate in shelters and those who organize shelters.[39] When new tax shelters are discovered, the government may respond through multiple avenues. Congress may amend the Code,[40] or the Treasury

31 See generally S Prt No 108-34 (cited in note 28).

32 Id at 28–29.

33 Id at 30.

34 Id at 30–32.

35 S Prt No 108-34 at 24, 53 (cited in note 28). Upon selling the strategy, the promoting firm would then take whatever actions were necessary to facilitate the implementation of the plan. See *IRS Implements Promoter Penalty by Analogy to Corporate Tax Shelter Rules*, 100 J Tax 247, 247 (2004).

36 S Prt No 108-34 at 7–8 (cited in note 28).

37 See Joseph Bankman, *The New Market in Corporate Tax Shelters*, 83 Tax Notes 1775, 1781 (1999).

38 See IRC §§ 6011, 6111–12.

39 See IRC § 6662 (imposing a penalty for underpayment of 20 percent in addition to the amount owed and specifically omitting tax shelters from a penalty reduction section); IRC § 6662A (authorizing the same penalties as § 6662 to reportable transactions); IRC § 6664 (preventing taxpayers from arguing reliance on the opinion of a tax adviser if that adviser is a material adviser who "participates in the organization, management, promotion, or sale" of the transaction for which the taxpayer underpaid); IRC § 6700 (imposing fines of up to $1,000 on any person who assists in organizing a tax shelter and 50 percent of the gross income derived from the shelter on those who participate in it).

40 Many of the early tax shelters were eliminated by the Tax Reform Act of 1986, Pub L No 99-514, 100 Stat 2085. New Code provisions in that Act, such as the passive-activity loss rules codified in IRC § 469, ended real estate shelters that took advantage of depreciation to defer tax payment for many years. Tax Reform Act of 1986 § 501, 100 Stat at 2233–41.

may promulgate new regulations or issue rulings that close the loopholes that are being exploited.[41]

In addition to efforts by Congress and the Treasury, courts have developed doctrines to disallow claimed tax savings from abusive tax shelters. If a transaction creates tax benefits in a way that is inconsistent with the Code or with congressional intent, a court may deny tax benefits even though the transaction complies with the literal language of the Code.[42] Under the business purpose doctrine, a court may disallow the claimed tax results of a transaction if the transaction lacked a legitimate business purpose, such as an expectation of making a profit.[43] In other words, if a taxpayer was motivated by no purpose other than the desire to secure some tax benefit, then those benefits may be denied by courts.[44] The closely related economic substance doctrine allows courts to disallow benefits if the transaction "lacks economic effects or substance other than the generation of tax benefits."[45] These tests developed as common law doctrines, but they were recently codified in IRC § 7701(o).[46] That provision explains that for a transaction to have economic substance, it must change the taxpayer's economic position "in a meaningful way," and the taxpayer must have a "substantial" nontax purpose for entering into the transaction.[47]

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41 See generally, for example, Tax Avoidance Using Artificially High Basis, Notice 2000-44, 2000-2 Cumulative Bull 255 (Sept 5, 2000) (making the Son of Boss tax shelter a "listed transaction" and explaining that its tax benefits would be challenged).

42 See, for example, *Knetsch v United States*, 364 US 361, 367–69 (1960) (rejecting the petitioner's literal interpretation of the Code because it was not the "meaning [that] plainly appear[ed]" when the statute as a whole and legislative history were considered).

43 See *Gregory v Helvering*, 293 US 465, 469–70 (1935).

44 See *Frank Lyon Co v United States*, 435 US 561, 583–84 (1978); *Stobie Creek Investments v United States*, 608 F3d 1366, 1376–77 (Fed Cir 2010) (concluding that a business was not entitled to a tax benefit because the transaction that created it lacked "economic reality," as there was no "reasonable possibility" of making a profit and the tax result was "purely fictional").

45 *Winn-Dixie Stores, Inc v Commissioner of Internal Revenue*, 254 F3d 1313, 1316 (11th Cir 2001). In *Winn-Dixie*, grocer Winn-Dixie purchased life insurance policies for its employees, then borrowed against those policies at high interest rates to purchase additional policies. Income on the cash value of a life insurance policy is tax exempt. Because interest payments on debt are normally deductible, Winn-Dixie stood to receive tax benefits of billions of dollars over sixty years. Id at 1315. Even though the relevant code provision explicitly allowed the claimed interest-payment deductions, the court disallowed the benefits. Id at 1316–17. The court relied on the fact that there was no chance that Winn-Dixie could have generated a pretax profit—the borrowing costs exceeded the value of the insurance policies. Additionally, a large grocer with tens of thousands of employees derives no real benefit from insuring every worker—corporate-owned life insurance is typically purchased only to insure against losing key employees. See id.

46 Health Care and Education Reconciliation Act of 2010 § 1409(a), Pub L No 111-152, 124 Stat 1029, 1067–68, codified at IRC § 7701(o).

47 Health Care and Education Reconciliation Act of 2010 § 1409(a), 124 Stat at 1068.

B. IRC § 7525 and Its Legislative History

Ever since nonlawyer tax professionals became authorized to practice before the IRS, there has been increasing competition between attorneys and accountants. Accounting firms have successfully gained control of a massive share of the market for tax services.[48] But before § 7525 was passed, tax attorneys still had the major advantage of the attorney–client privilege.

Although the attorney–client privilege varies slightly by jurisdiction, it generally applies to information that is communicated between a client and a lawyer in confidence and for the purpose of obtaining legal advice.[49] If a client claims the privilege and these elements are met, then any privileged materials are protected from summons in discovery. The privilege is held by the client until it is waived through disclosure to a party outside the attorney–client relationship.[50] But the attorney–client privilege does not apply to communications in furtherance of the client's participation in a crime or fraud (known as the "crime–fraud exception").[51] Tax lawyers may therefore prevent the IRS from receiving the bulk of tax planning memoranda as long as the transactions are not criminal or so abusive as to constitute fraud. This gave tax lawyers a strong advantage in attracting clients.

Accountants desired a similar privilege to keep from falling behind in the tax services market. In 1984, the Supreme Court explicitly affirmed that accountants do not enjoy a common law confidentiality privilege with their clients.[52] After this defeat in the court system, advocates of a nonlawyer privilege were forced to turn to Congress. The American Institute of Certified Public Accountants (AICPA) formed a coalition to sponsor legislation to create such a privilege.[53] Despite opposition by lawyers,[54] accountants finally succeeded in 1998 when Congress created the § 7525 privilege.

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48 See note 17.

49 See, for example, *United States v United Shoe Machinery Corp*, 89 F Supp 357, 358–59 (D Mass 1950).

50 Id.

51 Id. See also *In re Antitrust Grand Jury*, 805 F2d 155, 164 (6th Cir 1986). For a discussion of the relationship between the crime–fraud exception and the tax shelter exception, see note 179.

52 See *United States v Arthur Young & Co*, 465 US 805, 817 (1984) (declining to extend the attorney–client privilege to accountants).

53 See Bauman and Fowler, 14 Adv Tax at 39 (cited in note 13) (describing the AICPA's goal as to "level the playing field" because small businesses are unable to hire lawyers every time they need tax-related communications to be privileged).

54 See Jerome J. Shestack, *ABA Opposes Extension of the Attorney–Client Privilege to Nonlawyers*, 1998 Tax Notes Today 73-25, ¶¶ 1–3 (Apr 16, 1998). See also Paul R. Rice, *Accountant–Client Privilege: A Misdirected Debate*, 1998 Tax Notes Today 109-89, ¶¶ 3–6 (June 8, 1998)

1. The privilege.

Passed as part of the 184-page Internal Revenue Service Restructuring and Reform Act of 1998,[55] § 7525 secures for tax practitioners "the same common law protections of confidentiality" that exist under the common law attorney–client privilege.[56] These protections extend to "communication between a taxpayer and any federally authorized tax practitioner."[57] The privilege applies only in noncriminal tax proceedings, either before the IRS or in federal court if the United States is a party.[58]

Section 7525 protects only tax "advice."[59] This includes tax planning[60] and preparations for tax-related litigation.[61] Taxpayers may therefore seek to protect tax opinions, tax planning memoranda, written evaluations of how various transactions may be treated by the IRS, and documents detailing various alternatives that were considered during planning.[62] Communications regarding preparation of a tax return are not protected, because tax return preparation is not legal advice.[63] "Communications from a client that neither reflect the

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(describing attorneys' opposition to legislation granting accountants a privilege comparable to attorney–client privilege as being based on differing professional codes of conduct). Aside from the reasons explicitly articulated by the ABA, there were obvious personal interests at stake, because the extension of the privilege to nonlawyers would represent a "major loss of revenue for tax lawyers." Id at ¶ 3.

55 Pub L No 105-206, 112 Stat 685.

56 IRC § 7525(a)(1):

> With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

57 IRC § 7525(a)(1).

58 IRC § 7525(a)(2).

59 IRC § 7525(a)(1). The statute defines tax advice as "advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice [before the IRS]." IRC § 7525(a)(3)(B). Courts have specified that the services must be legal in nature. See *United States v Frederick*, 182 F3d 496, 502 (7th Cir 1999) (noting that the statute does not suggest that the privilege extends when nonlawyer tax practitioners "are doing other than lawyers' work"). See also *Evergreen Trading, LLC v United States*, 80 Fed Cl 122, 134 (2007) (analyzing legislative history to determine that § 7525 did not create a privilege that extends beyond the historic types of work protected by attorney–client privilege).

60 See Claudine Pease-Wingenter, *Does the Attorney–Client Privilege Apply to Tax Lawyers? An Examination of the Return Preparation Exception to Define the Parameters of Privilege in the Tax Context*, 47 Washburn L J 699, 725 (2008).

61 See *Valero*, 569 F3d at 630.

62 See Friedman and Mendelson, 27 Tax Adviser at 155 (cited in note 2).

63 *Frederick*, 182 F3d at 500 ("The information that a person furnishes the preparer of his tax return is furnished for the purpose of enabling the preparation of the return, not the preparation of a brief or an opinion letter."). See also *United States v KPMG LLP*, 237 F Supp 2d

lawyer's thinking nor are made for the purpose of eliciting the lawyer's professional advice or other legal assistance are not privileged."[64] Courts have clarified that the privilege is subject to the traditional limitations on the attorney–client privilege.[65]

Both the House and the Senate explanations of the privilege make clear that the goal was to increase parity between attorneys and nonattorneys doing the same tax work—that the privilege should not depend on "whether the advisor is also licensed to practice law."[66] According to the conference report, the goal of the provision was to allow taxpayers to consult with nonlawyer tax practitioners "in the same manner" that they consult with tax attorneys.[67]

2. The tax shelter exception.

Section 7525(a) describes the privilege, and § 7525(b) carves out the exception for tax shelter advice. The exception provides that the privilege does not extend to written communications that are "in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in § 6662(d)(2)(C)(ii))."[68] Section 6662(d) defines a tax shelter as "a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, *if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax*."[69] The tax practitioner privilege therefore does not apply when the adviser is "promoting" participation in transactions that have a "significant purpose" of avoiding federal income tax.

Because § 6662 uses the broad significant-purpose definition of tax shelter, the tax shelter exception might seem to reach most, if not all, tax planning communications with tax advisers. There is only one reason taxpayers pay tax advisers to communicate with them: to save

35, 42 (DDC 2002) (declining to apply the privilege to a letter concerning tax consequences of a past transaction because the advice was primarily for preparation of a tax return).

64 *Frederick*, 182 F3d at 500.

65 See, for example, *United States v BDO Seidman*, 337 F3d 802, 810 (7th Cir 2003).

66 Internal Revenue Service Restructuring and Reform Act of 1997, HR Rep No 105-364, 105th Cong, 1st Sess 66 (1997); Internal Revenue Service Restructuring and Reform Act of 1998, S Rep No 105-174, 105th Cong, 2d Sess 70 (1998).

67 HR Rep No 105-599 at 88 (cited in note 10).

68 IRC § 7525(b).

69 IRC § 6662(d)(2)(C)(ii) (emphasis added). Section 6662 is a penalty provision for the substantial understatement of taxable income. IRC § 6662(a). In general, if a taxpayer understates her income, but she relied on a favorable opinion from a tax professional in doing so, she is exempt from these penalties. IRC § 6662(d)(2)(B). There is, however, no safety in relying on tax advice for participation in a tax shelter. IRC § 6662(d)(2)(C). In other words, if a taxpayer understates her income because of a transaction that is later held to be an abusive tax shelter, then the taxpayer is subject to the penalties, with or without reliance on a professional opinion.

on taxes. When the exception was introduced, some worried that the exception would be applied to legitimate and routine tax advice.[70] Senator Connie Mack expressed dissatisfaction that the exception was "vague" and could arguably "be read to include all tax planning."[71] Senator Daniel Patrick Moynihan stated that due to the broad exception, "most taxpayers will never be eligible to assert [the privilege], and many will be surprised to learn about its limitations."[72]

Anticipating the concern that the exception might swallow all tax planning, the legislative history contains numerous statements regarding the exception's proper scope. On the floor of the Senate, Senator Mack stated that the exception "was meant to target written promotional and solicitation materials used by the peddlers of corporate tax shelters."[73] Recall that in 1998 the abusive practice of mass-marketing tax shelters was well underway and was led by the major accounting firms.[74] Legislators feared that, without the exception, the privilege would help large accounting firms evade government efforts to cut back on mass-marketed shelters.

Language in the conference report also suggests that the exception was intended to target abusive practices other than routine or individualized tax planning: "The Conferees do not understand the promotion of tax shelters to be part of the routine relationship between a tax practitioner and a client. Accordingly, the Conferees do not anticipate that the tax shelter limitation will adversely affect such routine relationships."[75]

As the preceding discussion shows, since the statute was enacted there has been tension between the broad definition of tax shelter (the significant-purpose definition) and the legislative record, which demonstrates Congress's intent that the exception not interfere with routine relationships. This tension set the stage for courtroom battles over the proper scope of the exception as it applied to "routine" relationships.[76]

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70 See note 135. See also Calvin H. Johnson, *Corporate Tax Shelters, 1997 and 1998*, 80 Tax Notes 1603, 1604 (1998) (emphasizing the broad scope of the significant-purpose definition).

71 144 Cong Rec S 14735 (July 8, 1998) (Sen Mack).

72 Id at S 14693 (Sen Moynihan).

73 Id at S 14735 (Sen Mack).

74 See notes 28–29 and accompanying text.

75 HR Rep No 105-599 at 269 (cited in note 10). This is the exact language relied on in *Countryside* when the court held that advice given in routine relationships is not promotion. *Countryside*, 132 Tax Ct at 353–54.

76 Since its passage in 1998, the tax practitioner privilege has been litigated several times. The earliest cases established that the privilege would protect only legal advice, because the privilege was no broader than the attorney–client privilege. Thus, it did not extend to the preparation of a tax return. *KPMG*, 237 F Supp 2d at 39; *Doe v KPMG, LLP*, 325 F Supp 2d 746, 753 (ND Tex 2004). Another line of cases addresses the question whether the § 7525

II. Two Views of "Promotion"

A. *Countryside*: Routine Advice Is Not "Promotion"

About two years after the *United States v Textron Inc*[77] district court opinion, the Tax Court decided *Countryside* and interpreted the exception similarly.[78] Timothy Egan, a partner at the accounting firm PricewaterhouseCoopers, had provided tax and accounting services to taxpayer Arthur Winn and the Winn Organization for twenty years.[79] These services included tax planning, filing tax returns, and responding to inquiries from tax officials.[80]

The IRS sought documents related to transactions that took place with Egan's assistance between 2001 and 2003.[81] These transactions involved the creation of the limited partnership Countryside LLP, in which Arthur Winn was a limited partner, and the distribution of nonmarketable securities in redemption of partnership interests.[82] The resulting tax consequences were very favorable for Winn. The IRS

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privilege may protect a taxpayer's identity. Compare *BDO Seidman*, 337 F3d at 812 (finding identity not to be privileged), with *United States v Arthur Andersen, LLP*, 273 F Supp 2d 955, 959–60 (ND Ill 2003) (finding identity to be privileged). Only a handful of these cases turned on an interpretation of the tax shelter exception. In *United States v BDO Seidman, LLP*, 492 F3d 806 (7th Cir 2007), the court held that the tax shelter exception applies regardless of whether the tax shelter is designed to shelter corporate or noncorporate taxes. Id at 823–24 (concluding that the definition of "tax shelter" is meant to be somewhat broad). In that case, the issue of "promotion" was not discussed because the accountant was mass-marketing prepackaged deals—there was no question that this constituted "promotion." See id at 808. Another case did not reach the exception because the court determined that the crime–fraud exception applied. *United States v Trenk*, 2009 WL 485375, *6–7 (D NJ). Because the § 7525 privilege is based on the attorney–client privilege, the crime–fraud exception is fully applicable. See note 181 and accompanying text.

In 2007, the District of Rhode Island in *United States v Textron Inc*, 507 F Supp 2d 138 (D RI 2007), vacd and remd, 577 F3d 21 (1st Cir 2009) (en banc), became the first court to examine the meaning of promotion and discuss how the exception might apply to long-term tax advisers giving customized advice. In that case, the IRS sought tax accrual work papers from taxpayer Textron. Textron claimed that the documents were protected by the § 7525 privilege. The court held that the privilege was waived when Textron turned the papers over to its independent auditor. *Textron*, 507 F Supp 2d at 151–52. The case was overruled by the First Circuit on other grounds, see *Textron*, 577 F3d at 31–32, but the district court commented on the scope of the tax shelter exception. The court asserted that the tax shelter exception "is aimed at communications by outside tax practitioners attempting to sell tax shelters to a corporate client." *Textron*, 507 F Supp 2d at 148. The court relied heavily on legislative history in concluding that the exception was in fact very narrow. Id.

77 507 F Supp 2d 138 (D RI 2007), vacd and remd, 577 F3d 21 (1st Cir 2009) (en banc).

78 *Countryside*, 132 Tax Ct at 353–54.

79 Id at 351–52.

80 Id at 352.

81 The subpoenaed documents consisted of "Meeting Minutes" recording confidential planning communications from meetings with Egan. Id at 348.

82 See *Countryside Limited Partnership v Commissioner of Internal Revenue*, 95 Tax Ct Mem Dec (CCH) 1006, 1007–09 (2008).

described these partnership transactions as "tax shelter transactions known as basis swaps."[83] Countryside claimed that the summoned documents were protected by the § 7525 privilege, and the IRS argued that the tax shelter exception applied because Egan had engaged in the promotion of Countryside's participation in a tax shelter. Countryside responded that this "one-on-one" advice was "the antithesis of a 'promotional' relationship."[84]

The court began by looking at various dictionary definitions of promote, then noted the disagreement among two district courts regarding the meaning of the term.[85] Concluding that the word was ambiguous, the Tax Court turned to the legislative history. The court quoted the conference report language: "The Conferees do not understand the promotion of tax shelters to be part of the routine relationship between a tax practitioner and a client."[86] Relying on this language, the court drew a distinction between advice given in the course of a close and ongoing relationship and the promotion of participation in a tax shelter.[87]

The court emphasized the closeness of Egan and Winn's advising relationship, describing in some detail the regular services rendered by Egan. Egan communicated with personnel at the Winn Organization each week, including in-person meetings once or twice a month.[88] The advice relating to the transactions under scrutiny was given in response to Winn's request.[89] Egan was paid a flat fee for his compliance work, and he billed the Winn Organization by the hour for all other services.[90] Because the promotion of tax shelters is not part of routine advising relationships (according to the conference report), the court held that Egan's advice for these transactions was not promotion. Thus, the exception did not apply, and the documents

83 *Countryside*, 132 Tax Ct at 351.

84 Id.

85 Id at 353. The two cases cited were the lower court decisions in *Valero Energy Corp v United States*, 2008 WL 4104368 (ND Ill), and *Textron*, neither of which was binding precedent. The Tax Court noted that *Textron* had determined that promotion applied to "the peddling of prepackaged tax shelters," *Countryside*, 132 Tax Ct at 353, citing *Textron*, 507 F Supp 2d at 148, while *Valero* had concluded that "promotion" applied more broadly to include advisers "who organize[] or assist[] in organizing a tax shelter." *Countryside*, 132 Tax Ct at 353, quoting *Valero*, 2008 WL 4104368 at *18.

86 *Countryside*, 132 Tax Ct at 353–54, quoting HR Rep 105-599 at 269 (cited in note 10).

87 *Countryside*, 132 Tax Ct at 354–55.

88 Id at 352.

89 Id at 354. ("Mr. Egan provided tax advice to the Winn organization when requested to do so."). See also id at 352 (explaining that Egan "did not rely on any generic prototypes, descriptive materials, or files maintained by [PricewaterhouseCoopers]").

90 Id at 352.

were privileged under § 7525.[91] In short, *Countryside* relies on the legislative history and stands for the proposition that custom tax advice given in a close and ongoing relationship is not promotion.[92]

B. *Valero*: Routine Advising May Be Promotion

Just over a week after the Tax Court opinion was released, the Seventh Circuit examined the same issue and came to the opposite result in *Valero*.[93] Valero Energy Corporation is a large, Texas-based oil refining company.[94] In December 2001, Valero acquired Ultramar Diamond Shamrock Corporation and its Canadian subsidiaries. In 2002, Valero took advantage of the low relative value of Canadian currency at the time and engaged in a complex set of transactions that generated $105 million in tax-deductible foreign-currency losses.[95] These transactions were conducted at the advice and with the help of the corporation's long-time tax advisers and accountants at Arthur Andersen. The transactions consisted of "the creation of spin-off entities, several same-day wire transfers of cash, a large distribution from one of the Canadian subsidiaries to a United-States-based parent, re-classification of a separate foreign subsidiary as a branch of Valero for tax purposes, and the extinguishment of debt."[96]

The IRS attempted to obtain various documents prepared by Valero's long-time accountants in connection with these transactions. Valero claimed that the documents were protected under § 7525. Valero, like Countryside, argued that the legislative history showed that the tax shelter exception was not intended to apply to individualized advice given in an ongoing advising relationship.[97] To give effect to this congressional intent, Valero argued that promotion must mean the active marketing of prepackaged tax shelters through advertising.[98] The IRS, by contrast, argued that promotion simply means "furtherance" or "encouragement."[99]

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91 *Countryside*, 132 Tax Ct at 354–55. *Countryside* does not set forth a bright-line rule. At some point, a tax practitioner acting in the context of a routine relationship may "cross the line." Id at 354.

92 See Randolph J. Buchanan, *Corporate Tax Shelter Exception to the Accountant–Client Privilege*, 96 Tax Notes 1619, 1626–27 (2002) (suggesting shortly after the bill's passage that this was the proper interpretation of the exception).

93 569 F3d at 634.

94 Id at 628.

95 Id.

96 Id.

97 *Valero*, 569 F3d at 632.

98 Id.

99 Id.

The court reviewed the text of the statute and the referenced tax shelter definition in § 6662 (the significant-purpose definition),[100] concluding that "[n]othing in this definition limits tax shelters to cookie-cutter products peddled by shady practitioners or distinguishes tax shelters from individualized tax advice."[101] The documents that the IRS sought were prepared as part of a plan to avoid payment of taxes, and therefore fell squarely within the exception.[102] And adopting Valero's narrow definition of promotion would have the effect of narrowing § 6662's intentionally broad definition.[103] Because this narrow definition of promotion would create an internal conflict, the court rejected it. The court concluded that the advice was promotion and that the tax shelter exception applied.[104]

* * *

In sum, the two primary cases interpreting promotion take divergent approaches. *Countryside* focused on legislative history and determined that the exception should not apply to long-term advisers giving custom advice. *Valero* represents the opposite approach, focusing on the broad significant-purpose definition of tax shelter. *Valero* declined to give weight to the legislative history and applied the exception without considering the closeness or length of the advising relationship.

III. BROADENING AND NARROWING THE SCOPE OF THE EXCEPTION

Current case law leaves the application of the tax shelter exception in doubt—especially as it relates to advice given by long-time advisers. *Countryside* holds that "promotion" is typically limited to advice given outside of a long-term relationship, while *Valero* holds that there is no such limitation. This Part resolves the disagreement and proposes an understanding of the tax shelter exception that is true to the Code and the Treasury regulations. Part III.A argues that *Countryside*'s approach should be rejected. There is no statutory basis for considering the length or closeness of the relationship, and canons of interpretation suggest a broader meaning of promotion. Instead, courts should follow *Valero*'s broader understanding of promotion as furtherance or encouragement.

100 Id.
101 *Valero*, 569 F3d at 632.
102 See id at 629, 634.
103 Id at 632.
104 See id at 634.

Valero's approach is incomplete, however, because it fails to articulate meaningful limits to ensure that normal tax planning can still be privileged; *Valero* fails to ensure that the exception will not swallow the rule. Part III.B resolves this problem by showing that Treasury regulations suggest it would be proper to place limitations on the definition of tax shelter to exempt routine customized planning from the scope of the § 7525(b) exception. Part III.C concludes with an outline of the decision process that courts should use to determine whether there was tax shelter promotion.

A. Broadening *Countryside*'s Narrow View of Promotion

Tax shelter promotion, properly understood, has nothing to do with the length or the closeness of the advising relationship. The Tax Court concluded otherwise. This section shows that it reached the wrong result—promotion should be interpreted broadly to mean furtherance or encouragement. Because the *Countryside* decision was based almost exclusively on the legislative history, this section first reexamines the conference report language on which the court relied. This section shows that the language was ambiguous. And, with no real support from the legislative history, there is no textual support for the Tax Court's position limiting the term promotion. This section then proceeds to show that a court need not even reach the legislative history to properly interpret promotion—the application of two rules of statutory interpretation tips the scales in favor of a broader definition of promotion.

1. A second look at the legislative history.

After concluding that promotion was ambiguous as used in the statute, the Tax Court turned to the legislative history. Because the conference report indicated that the exception should not interfere with routine planning, the Tax Court determined that promotion does not occur when advice is given as part of a routine relationship.[105]

The language on which the court relied is ambiguous: "The Conferees do not understand the promotion of tax shelters to be part of the routine relationship between a tax practitioner and a client. Accordingly, the Conferees do not anticipate that the tax shelter limitation will adversely affect such routine relationships."[106] The court treats this as a statement meant to clarify the meaning of promotion—if an adviser has a routine relationship with a client, then any advice

105 *Countryside*, 132 Tax Ct at 352–53.

106 HR Rep No 105-599 at 269 (cited in note 10).

given is not promotion. But there is an alternative, equally plausible reading of this language—that the statement clarifies the meaning of "routine relationship." If an adviser is promoting tax shelters, then the advising relationship is not "routine." Read this way, the conference report offers no support for the Tax Court's position. Instead, the conferees were simply explaining why they were not concerned that the exception would ruin proper advising relationships: proper advising relationships do not involve tax shelter promotion.

One court read this same language a third way in 2007. The Seventh Circuit, in *United States v BDO Seidman, LLP*,[107] interpreted this language as articulating the *rationale* for the tax shelter exception, rather than as a limitation on the meaning of promotion or routine relationship.[108] The court quoted the conference report and then explained that this rationale for the exception "goes to the necessity of the communications to achieve the beneficial aims of the privilege."[109] In other words, the conference report was emphasizing that the beneficial goal of the privilege is to encourage open communication with routine advisers who give legitimate planning advice. If an adviser is promoting tax shelters, then there is no social value in protecting those communications from subpoena. The privilege therefore does not extend to advisers who are promoting tax shelters. There are thus at least three plausible ways to read the conference report language on which *Countryside* relied. The Tax Court erred by failing to consider—or even acknowledge—these alternative plausible readings, relying solely on ambiguous legislative history to adopt a narrow interpretation of promotion.

2. Canons of interpretation favor a broader meaning of promotion.

The previous section showed that the Tax Court stood on weak ground in relying on the legislative history to interpret promotion narrowly. This section goes further and sets forth a more correct understanding of promotion. Guided by two canons of statutory interpretation, this Comment suggests that promotion be interpreted broadly to mean furtherance or encouragement.[110]

107 492 F3d 806 (7th Cir 2007).

108 Id at 822.

109 Id.

110 Several early commentators—prior to *Textron*—appeared to interpret promotion broadly as well. See, for example, Peter H. Blessing, *Privileged Communications in the Context of U.S. Tax Practice*, 572 PLI/Tax 9, 27 (2003) (considering whether promotion requires that the adviser suggest using a particular transaction, or whether it can include simply advising on the legality of a transaction).

a) The presumption that Congress uses the same term consistently in different statutes. When statutes on the same subject matter contain similar terms, courts interpreting those statutes should presume that the terms are used consistently.[111] This presumption can be overcome if there is evidence to the contrary, but when the meaning of a term is unclear from the text of the statute, it is reasonable to start the interpretive process by looking at how the term is defined in other statutes. This rule is similar to the "*in pari materia*" rule that laws on the same subject matter are to be interpreted with reference to each other.[112]

Several provisions of the Code deal specifically with tax shelters. Many of these provisions define—or at least inform the meaning of—promotion. These provisions suggest that promotion should be interpreted broadly to mean any positive encouragement or assistance. Because the provisions all deal with tax shelters and use terms similar to promotion, a court should presume that the terms are used consistently. These other provisions can therefore inform our understanding of promotion for purposes of § 7525. *Countryside* rejected this idea and declined to draw any inference about the meaning of promotion from these other Code provisions.[113]

First, in 1998—the same year that § 7525 was passed—IRC § 6111 defined a promoter as "any person . . . who participates in the organization, management, or sale of [a] tax shelter."[114] Although this section has since been amended and the definition no longer remains,[115] this shows that in 1998 Congress understood "promotion"

111 *Smith v City of Jackson, Mississippi*, 544 US 228, 233 (2005) ("[W]hen Congress uses the same language in two statutes having similar purposes . . . it is appropriate to presume that Congress intended that text to have the same meaning in both statutes."). See also Jacob Scott, *Codified Canons and the Common Law of Interpretation*, 98 Georgetown L J 341, 374–75 (2010) (discussing the consistent use of one definition across multiple statutes as one of several methods used to create continuity in the law).

112 See *Harris v Commissioner of Internal Revenue*, 340 US 106, 107–08 (1950) (applying the "*in pari materia*" rule to the estate tax and gift tax); *Black's Law Dictionary* 791 (West 6th ed 1990) (defining "*in pari materia*" as "upon the same matter or subject"). The *in pari materia* canon depends on the supposition that, when Congress passes related statutes, those statutes were designed to be harmonious and consistent with each other. Consider *Harris*, 340 US at 107–08.

113 132 Tax Ct at 355 n 8 (declining to use potentially informative definitions of promoter found in § 6111 and § 6700 because Congress referred solely to § 6662 when § 7525 was passed).

114 IRC § 6111(d) (2000), amended by Gulf Opportunity Zone Act of 2005 § 412(zz), Pub L No 109-135, 119 Stat 2577, 2641.

115 The prior version of § 6111 required certain tax shelter promoters to register their tax shelters with the IRS. The current version requires "material advisor[s]" (rather than "promoters") who assist with "reportable" transactions to report the details of those transactions. The statute defines a material adviser as "any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction," and who derives income above a certain amount for her assistance. IRC § 6111(b).

to include organization and management of tax shelters. Second, IRC § 6700, which is titled "Promoting abusive tax shelters, etc.," imposes a penalty on anyone who "organizes" or "participates . . . in the sale of" an abusive tax shelter.[116] Although the statute does not define promoting, the title is informative of the content of the statute.[117] The use of the term "[p]romoting" in the title therefore suggests that organizing *or* selling a tax shelter for a fee could be considered promotion.

These two Code provisions suggest that promotion is much more than selling or marketing. The prior version of § 6111, which defined promoter, tells us that promotion should include organization, management, or sale. Section 6700 tells us that promotion should include participating in the organization or sale of a tax shelter. These broad definitions indicate that promotion covers the wide array of activities necessary to implement a tax shelter: creating the shelter idea, developing the plan, finding participants, marketing, and coordinating all of the players.[118] These activities are not limited to the mass marketing of prepackaged tax shelters. Contrary to the holding in *Countryside*, all of these activities can easily be performed in the context of a long-term relationship. Rather than defining promotion in terms of the advising relationship, a better definition is furtherance or encouragement.[119]

Admittedly, drawing inferences from these two Code provisions has its weaknesses. Sections 6111 and 6700 use the terms "promoter" and "promoting," respectively—neither explicitly defines the word "promotion." Promoting is used in the title of § 6700 rather than in an in-text definition, and there is no textual evidence in these provisions that either of the terms was intended to define promotion in other parts of the Code.[120] Despite these weaknesses, there is still the

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116 IRC § 6700(a)(1). Section 6700 is designed to penalize the organizers and promoters of certain abusive tax shelters. If a promoter makes fraudulent statements regarding the tax treatment of a transaction or provides tax advice that turns out to cause the taxpayer to "grossly understate" her tax burden, then the promoter is subject to a fine. See IRC § 6700.

117 See *Porter v Nussle*, 534 US 516, 527–28 (2002); *Almendarez-Torres v United States*, 523 US 224, 234 (1998) ("We [ ] note that 'the title of a statute and the heading of a section' are 'tools available for the resolution of a doubt' about the meaning of a statute."), quoting *Brotherhood of Railroad Trainmen v Baltimore & Ohio Railroad Co*, 331 US 519, 528–29 (1947).

118 Outside of the Code, promoter often has a broader meaning as well. See, for example, Robert E. Swanson and Barbara Mardinly Swanson, *Tax Shelters: A Guide for Investors and Their Advisors* 7 (Dow Jones-Irwin 1982) (describing the promoter as "the person who puts the deal together").

119 The district court in *Valero* made this same point. *Valero Energy Corp v United States*, 2008 WL 4104368, *17–18 (ND Ill) (defining promotion in terms of the actions taken rather than in terms of the relationship between the parties).

120 In fact, the definition of promoter in § 6111 was preceded by the qualifier "For purposes of [§ 6111(d)] . . . ." IRC § 6111(d)(2) (2000).

background presumption that the terms are used similarly.[121] Rather than rely on ambiguous legislative history,[122] *Countryside* should have applied this presumption and drawn meaning from these other provisions. As such, the Tax Court's distinction between promotion and long-term advising should be rejected.

b) The presumption in favor of disclosure. The narrow reading of the tax shelter exception should further be rejected because the Supreme Court held that courts should not restrict the IRS's summons power[123] "absent unambiguous directions from Congress."[124] This direction from the Supreme Court creates a presumption in favor of disclosure when the scope of privilege is unclear. Because the United States tax system relies so heavily on the honesty of taxpayers in reporting their tax liability, the threat of a strong summons power is essential.[125] Courts should therefore be slow to adopt broad interpretations of privilege based only on ambiguous legislative history.

Countryside violated the presumption in favor of disclosure by narrowly interpreting an exception to privilege without the required "unambiguous direction[] from Congress." Section 7525 provided no clues to the meaning of the term promotion, so the court turned to, and relied on, unclear language from the conference report.[126] Of three plausible readings of the legislative history,[127] the court inappropriately chose a reading that severely restricted the IRS's summons power based on the length or quality of the tax-advising relationship.

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121 See note 111.

122 Many scholars and judges have argued that relying on legislative history should be disfavored generally because the history can often be read any way the court wants to read it. See, for example, Frank H. Easterbrook, *Judicial Discretion in Statutory Interpretation*, 57 Okla L Rev 1, 18 (2004) (quoting Judge Harold Leventhal as stating that "legislative history is like looking over the crowd at a cocktail party and picking out your friends"); Frank H. Easterbrook, *What Does Legislative History Tell Us?*, 66 Chi Kent L Rev 441, 446–47 (1990).

123 See IRC § 7602 (authorizing the IRS to examine documents and summon witnesses to determine the accuracy of a return or collect an amount owed).

124 *United States v Arthur Young & Co*, 465 US 805, 816 (1984) (justifying the need for explicit congressional direction for limitations on the IRS's summons power on the grounds that this power was essential to ensure that the national tax burden is distributed fairly and equitably). See also *United States v First Bank*, 737 F2d 269, 273 (2d Cir 1984). The Seventh Circuit made this point in *Valero* when it noted that Valero's position was at odds with the "IRS's broad summons power." 569 F3d at 633, citing IRC § 7602(a). The court then determined that the word "promotion" was "not a clear enough signal" to limit the tax shelter exception to mass-marketed shelters. *Valero*, 569 F3d at 633.

125 See *Arthur Young*, 465 US at 815–17.

126 See text accompanying notes 86–87.

127 See Part III.A.1.

For these reasons, the distinction between promotion and long-term advising relationships should be rejected.[128] The legislative history does not compel (or even necessarily suggest) such a result. When courts are faced with deciding whether there was promotion of a tax shelter, they should not give weight to the length of the advising relationship. Until there is "unambiguous" direction to the contrary, courts should read promotion broadly to mean furtherance or encouragement, as suggested by similar uses of promoter and promoting in the Code.[129]

B. Narrowing *Valero*'s Broad View of "Tax Shelter"

Countryside may have been correct to follow the conference report and in trying to limit the scope of the exception so that routine planning was not covered, but, as shown above, the court was incorrect to place limits on the word "promotion." The court could have reached a proper (and possibly identical[130]) result by focusing instead on the definition of tax shelter. *Valero* took a broad view of tax shelter, and this section argues that this view should be narrowed. This section proposes an understanding of the § 6662 tax shelter definition that *will not* result in the exception swallowing the rule. The limitations focus on the meaning of the phrase "significant purpose." Part III.B.1 discusses problems with the Seventh Circuit's application of the § 6662 definition. Part III.B.2 proposes a new standard based on Treasury regulations.

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128 One of the strongest arguments supporting *Countryside* was not even raised in the opinion. It was suggested in the *Valero* taxpayer's briefs. Brief for Appellant Valero Energy Corporation, *Valero Energy Corp v United States*, No 08-3473, *37 (7th Cir filed Nov 12, 2008) (available on Westlaw at 2008 WL 5789493). The argument is that promotion is a term of art meaning "sale" when discussing tax shelters. See Jeremiah Coder, *Seventh Circuit Upholds Broad Shelter Promotion Exception*, 123 Tax Notes 1399, 1401–02 (2009). See also Beale, 25 Va Tax Rev at 596–97 (cited in note 25) (arguing that the abusive practices of inside advisers are no different from those of outside marketers, but frequently associating the term "promoter" with the latter rather than the former). While this argument may have some merit, its weaknesses are that (1) there is still no textual support for that kind of limitation, and (2) there are instances in which promotion or promoter is not restricted to sales. See note 118.

129 This definition of promotion is consistent with a definition of promoter that the Tax Court has applied for purposes of determining good-faith reliance on tax advice. Section 6662 is an underpayment penalty provision, see note 69, but the taxpayer may avoid the penalty if he had good cause for the underpayment. IRC § 6664(c). Good-faith reliance on professional tax advice may be good cause for underpayment, but taxpayers generally may not rely, even in good faith, on advice from a promoter. See *Tigers Eye Trading, LLC v Commissioner of Internal Revenue*, 97 Tax Ct Mem Dec (CCH) 1622, 1633–34 (2009). In this context, the Tax Court has defined a promoter as "an adviser who participated in structuring the transaction or is otherwise related to, has an interest in, or profits from the transaction." Id.

130 See text accompanying notes 183–84.

1. The vague significant-purpose tax shelter definition.

Recall that a tax shelter is defined essentially as any transaction with a significant purpose of tax avoidance.[131] This definition seems to depend only on the apparent motives for the transaction and makes no mention of the underlying substance or of whether the attempted tax avoidance is consistent with the Code or with congressional intent. On its face, then, the tax shelter exception appears to reach legitimate tax planning, as long as tax avoidance was a significant purpose.[132] From the year of its passage, the significant purpose definition has been regularly criticized as vague[133] and overbroad.[134] Several academics have called for Congress and the Treasury to provide additional guidance, and a few have proposed more concrete interpretations of the phrase.[135] Nevertheless, the definition of significant purpose remains unclear.[136]

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131 See text accompanying notes 69–70.

132 Recall that § 7525 references the § 6662 definition of "tax shelter."

133 See, for example, Shane Jasmine Young, Note, *Pierce the Privilege or Give 'Em Shelter? The Applicability of Privilege in Tax Shelter Cases*, 5 Nev L J 767, 792–93 (2005) (cautioning that, due to the broad tax shelter definition, it is "ill-advised" for tax practitioners to rely on the § 7525 privilege).

134 See, for example, AICPA, *AICPA Comments on Regs Regarding Changes to Circular 230*, 2004 Tax Notes Today 32-29, ¶ 14 (Feb 18, 2004) (urging the IRS to amend the definition of tax shelter in a Treasury regulation because it relied on the § 6662(d) definition, which the AICPA contended "lacks clear definition, is overly-broad, and may result in inconsistent administration or enforcement"); Burgess J.W. Raby and William L. Raby, *Penalty Protection for the Taxpayer: Circular 230 and the Code*, 107 Tax Notes 1257, 1258 (2005) ("Getting married on December 31, 2005, rather than January 1, 2006, might be viewed as having a significant purpose of tax avoidance by some people and in some circumstances."). But see Johnson, 80 Tax Notes at 1610–11 (cited in note 70) (arguing that a broad significant-purpose test is essential due to the creativity of tax planners and the complexity of the structures they design). Several of these commentators are actually discussing the significant-purpose definition found in Circular 230. See 31 CFR § 10.35(b)(2)(i)(C). This ethics rule uses language very similar to that in § 6662, and commentators frequently discuss them together. Neither the IRS nor courts have explained the meaning of the significant-purpose definition for purposes of Circular 230. See note 136.

135 For example, two commentators suggested that if a transaction is motivated anywhere from 5 to 33 percent by the tax considerations, then those considerations were a significant purpose. See Jordan P. Weiss and Raffi S. Baroutjian, *A New Standard for Corporate Tax Shelters*, 22 LA Law 26, 27 (Sept 1999). Another commentator uses a method similar to the one proposed in this Comment. See Nathan W. Giesselman, *A Significant Problem Defining a "Significant Purpose" and the Significant Difficulties That Result*, 111 Tax Notes 1119, 1124–28 (2006) (looking at four regulations, including the regulations enacted pursuant to § 6111, to suggest a limited meaning of significant purpose). Giesselman concludes that the regulations do not provide a satisfactory definition. Id at 1129–30.

136 Letter from the New York State Bar Association Tax Section to the Chairmen and Ranking Members of the Senate Finance Committee and House Ways and Means Committee *10 & n 25 (Sept 22, 2009), online at http://www.nysba.org/AM/Template.cfm?Section=Tax_Section_Reports_2009&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=32062 (visited Jan 25, 2011) ("[W]hatever limitations may exist on the 'significant purpose tax shelter' concept have not yet been clearly articulated."); Giesselman, 111 Tax Notes at 1120, 1123 (cited

Valero is incomplete, because it fails to establish proper limits on the significant-purpose definition.[137] The Seventh Circuit conceded that, under its analysis, the exception "could . . . include some legitimate attempts by a company to reduce its tax burden."[138] The district court gave no serious consideration to whether the claimed benefits were acceptable, basing its decision almost solely on the apparent motivations for performing the transactions.[139] At trial, Valero argued that the claimed tax benefits were proper, so the transaction could not properly be considered a tax shelter. The court dismissed this argument: "Valero focuses its argument on why the transactions at issue had legitimate business purposes, rather than trying to explain how or why tax avoidance was not a significant purpose of those transactions."[140] In other words, the court did not care about the possibility that the transaction had a business purpose and that the claimed tax benefits might actually be consistent with the Code. The court briefly mentioned the potential impropriety of the claimed benefits, then simply concluded that, "at a minimum," tax avoidance was a significant purpose.[141] According to one practitioner, "[t]he court missed an opportunity to impose a meaningful standard."[142] If other courts follow this example, the tax shelter exception could swallow almost all of the privilege. In other words, if courts ask only whether the taxpayer sought to reduce his tax burden, and fail to consider whether those tax benefits are proper, then almost all tax planning documents will be available to the IRS in discovery.

in note 135). See also Raby and Raby, 107 Tax Notes at 1257–58 (cited in note 134); Edward M. Polansky, *Texas CPA Group Voices Support for Proposed Circular 230 Regs.*, 2010 Tax Notes Today 195-15 (Oct 8, 2010) (explaining that the IRS has given no guidance on the meaning of the significant-purpose language).

137 J.P. Finet, Alison Bennett, and Melinda Hanson, *Seventh Circuit Adopts Expansive Definition of "Promote a Tax Shelter" in Privilege Case*, 77 USLW 1806, 1807–08 (2009) (quoting several tax practitioners opining that *Valero* significantly broadens the exception in a way that can be applied to lots of planning). But see Gregory M. Fowler, *The* Valero *Cases: New Meaning for "Significant Purpose" Definition?*, 2008 Tax Notes Today 219-28 (Nov 12, 2008) (arguing that *Valero* opens the door for the business purpose test to be considered as part of the § 6662 definition).

138 *Valero*, 569 F3d at 632.

139 See *Valero*, 2008 WL 4104368 at *15–16.

140 Id at *15.

141 Id at *16.

142 Jeremiah Coder, *Court Finds Shelter Exception to Tax Practitioner Privilege*, 120 Tax Notes 627, 629 (2008) (describing a tax practitioner's concern that "applying the court's analysis means that virtually any transaction with significant income tax consequences—such as setting up IRAs or buying a house—meets the technical definition of a tax shelter").

2. A proposed standard based on Treasury regulations.

The Treasury Department has broad authority to issue interpretive regulations necessary for administering the complex tax system.[143] The Supreme Court recently affirmed that courts should apply *Chevron* deference to these regulations,[144] so there is no question that the Treasury regulations are authoritative. Two regulations suggest that the tax shelter definition in § 6662 does not include routine and customized tax planning, even if tax considerations motivated the transaction. Part of this Comment's proposed test is derived from old regulations under § 6662 that explain what it means for a transaction to have a "principal purpose" of tax avoidance. The bulk of the test is derived from the regulations under § 6111, which used to contain nearly identical significant-purpose language to that currently found in § 6662. It is important to emphasize that neither of these regulations is a perfect guide for interpreting the § 6662 definition.[145]

First, we look to the regulations for § 6662. Treasury Regulation § 1.6662-4 interprets the definition of tax shelter given in § 6662.[146] This regulation, however, has not been updated to reflect changes made to the statute in 1997. Prior to 1997, § 6662 used the phrase "principal purpose" instead of "significant purpose"—a tax shelter was any plan or transaction with a "principal purpose" of avoiding income tax.[147] Although Regulation § 1.6662-4 interprets the meaning of principal purpose rather than significant purpose, the limits it places on the principal-purpose tax shelter definition are informative:

> The principal purpose of an entity, plan or arrangement is not to avoid or evade Federal income tax if the entity, plan or arrangement has as its purpose the claiming of exclusions from income, accelerated deductions or other tax benefits *in a manner consistent with the statute and Congressional purpose*.[148]

143 IRC § 7805(a) ("[T]he Secretary shall prescribe all needful rules and regulations for the enforcement of [the Code].").

144 *Mayo Foundation for Medical Education and Research v United States*, 131 S Ct 704, 713 (2011) ("The principles underlying our decision in *Chevron* apply with full force in the tax context.").

145 Other commentators have looked to these and other regulations to suggest roughly similar limits on the definition. See note 135.

146 See Treas Reg § 1.6662-4(g)(2) (elaborating on the "principal purpose" tax shelter definition).

147 IRC § 6662(d) (1994), amended by Taxpayer Relief Act of 1997 § 1028(c)(2), Pub L No 105-34, 111 Stat 788, 928.

148 Treas Reg § 1.6662-4(g)(2)(ii) (emphasis added).

The regulation goes on to carve out several types of transactions that are motivated solely by their tax benefits but are not tax shelters because the tax benefits comport with congressional intent. A few of these include purchasing municipal bonds with tax-exempt interest, taking the maximum allowable depreciation deductions under the Code, choosing to deduct intangible drilling and development costs as permitted by statute, establishing a tax-favored retirement plan, and choosing to be taxed as a pass-through entity to escape the double-layered tax for corporations.[149] In short, this Regulation created a safe harbor for tax planning decisions that were perfectly consistent with the Code and congressional purpose, even though arguably all of the examples listed are activities that would be done for the principal purpose of avoiding taxes.

The existence of this safe harbor under the old definition provides support for the judicial creation of a similar safe harbor under the new definition. Although the change from principal purpose to significant purpose was probably intended to cast a wider net, there is no reason to think that this kind of safe harbor should no longer exist. If a judge can tell that certain claimed tax benefits are consistent with the Code and congressional purpose, then there is no benefit to allowing discovery of the associated planning documents.[150] Imagine two transactions, *X* and *Y*. Transaction *X* is motivated 90 percent (principally) by its tax benefits, and transaction *Y* is motivated 30 percent (significantly) by its tax benefits. For both transactions, the tax benefits are consistent with the Code and with congressional purpose. Under the safe harbor in the outdated regulations, transaction *X* would not be a tax shelter. Without a similar limitation, transaction *Y* would be a tax shelter under amended § 6662(d). It would be absurd, however, to suggest that the Treasury would subject transaction *Y* to stricter scrutiny and greater penalties than transaction *X*—the tax considerations were greater in transaction *X* than in transaction *Y*.[151] So the first limitation from the regulations is that the significant-purpose requirement is not satisfied if the claimed benefits are consistent with the Code and with congressional purpose.

The second limitation comes from the regulations under § 6111. The 1997 change from principal to significant was intended by Congress to make the § 6662 definition consistent with the newly created tax shelter definition in § 6111(d)(1). The conference report explains: "This modification conforms the definition of tax shelter for

149 Treas Reg § 1.6662-4(g)(2)(ii).

150 See Kip Dellinger, *The Proposed, New and Improved Tax Preparer Standard: Will Tragedy Become Farce?*, 119 Tax Notes 867, 871 (2008).

151 See id at 869.

purposes of the substantial understatement penalty to the definition of tax shelter for purposes of these new confidential corporate tax shelter registration requirements."[152] The definition of tax shelter in § 6111 at that time[153] was more detailed than the definition in § 6662,[154] but both definitions had the significant-purpose requirement in 1997. Treasury Regulation § 301.6111-2(b) gives specific guidance on the meaning of the significant-purpose requirement in § 6111.[155] Because the § 6662 definition was changed to make it "conform" to the § 6111 definition, and given the lack of guidance under the regulations for § 6111, a court interpreting the meaning of significant purpose should look to these specifications in Regulation § 301.6111-2(b).[156]

Under Regulation § 301.6111-2(b), there are two ways that a transaction may have tax avoidance as a significant purpose. First, the significant-purpose requirement of the old § 6111(d) tax shelter definition is met if the transaction is one of many "listed transactions" previously identified by the IRS as tax-avoidance transactions.[157] This widely available list contains transactions known to be highly abusive, many of which were once marketed heavily.[158] Examples of such transactions include lease-in, lease-out transactions; debt straddles; and abusive Roth IRA transactions.[159]

Second, the significant-purpose requirement is met if the tax adviser "reasonably expects the transaction to be presented in the same or substantially similar form to more than one potential

152 Revenue Reconciliation Act of 1997, HR Rep No 105-148, 105th Cong, 1st Sess 471 (1997), reprinted in 1997 USCCAN 678, 865.

153 Section 6111 was amended in 2004. See American Jobs Creation Act of 2004 § 815(a), Pub L No 108-357, 118 Stat 1418, 1518, codified as amended at IRC § 6111. The significant-purpose language is no longer used.

154 Section 6111 contained additional requirements regarding promoter fees and confidentiality agreements. See IRC § 6111 (1994 & Supp 1997).

155 See Treas Reg § 301.6111-2(b).

156 It should be noted that the guidance accompanying the temporary regulation that preceded Regulation § 301.6111-2 specifically stated that the Regulation did not apply to the tax shelter definition in § 6662. IRS, Corporate Tax Shelter Registration Temporary Regulation, 65 Fed Reg 11215, 11215, 11217–18 (2000). No similar limitation exists in the text of the Regulation itself. See Treas Reg § 301.6111-2. See also *BDO Seidman*, 492 F3d at 825 (stating that the regulations for § 6111 are of little relevance to interpreting § 6662). In that case, the taxpayer argued that the regulations for § 6111 limited the § 6662 definition to C corporations, even though no such limiting language existed in the text of § 6662. Id. The argument for giving weight to the § 6111 regulations is stronger here where we are interpreting the significant-purpose language shared by the two statutes.

157 See Treas Reg § 301.6111-2(b)(2).

158 See IRS, *Listed Transactions—LB&I Tier I Issues* (cited in note 23) (listing thirty-four potentially abusive transactions).

159 See id.

participant."[160] The regulation explains that "substantially similar" is to be "broadly construed."[161] It includes "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."[162] Because so many tax advisers serve multiple clients and help all of them reduce their tax burdens, it is important to consider at what point two transactions are substantially similar and therefore would fall under this prong of the tax shelter definition. Although the question whether a transaction will be presented in substantially similar form to other taxpayers may be slightly more complex,[163] this Comment proposes a few of the factors that courts should consider when deciding whether tax advice is customized, as opposed to advice that is likely to be presented in substantially similar form to multiple taxpayers.

Factors indicating that advice is customized (or is advice that is *not* expected to be presented to multiple participants in substantially similar form) include: (1) the advice was given in response to a specific request by the taxpayer; (2) the advice was designed to reduce the tax burden for a transaction that will go forward independent of the ultimate tax consequences; and (3) the existence of a valid—and relatively unique—business purpose.[164] Factors indicating that advice

160 Treas Reg § 301.6111-2(b)(3). Under this second prong, the tax benefits must constitute an "important part of the intended results of the transaction." Treas Reg § 301.6111-2(b)(3). This requirement is not a significant limitation—tax considerations are a serious aspect any time a tax adviser is consulted. This Comment therefore ignores this element.

The Regulation also exempts from this provision transactions for which the promoter or adviser reasonably determines that: (1) the taxpayer will likely "participate in the transaction in the ordinary course of its business in a form consistent with customary commercial practice," and (2) "[t]here is a generally accepted understanding that the expected Federal income tax benefits . . . are properly allowable under the Internal Revenue Code." Treas Reg § 301.6111-2(b)(3). As noted above, the old regulations for § 6662 exempted tax benefits that are consistent with the Code and congressional purpose. See text accompanying note 148. This two-part exception serves essentially the same role—it exempts transactions that are readily apparent as accepted tax planning. For purposes of articulating a standard, this exception will therefore be ignored.

161 Treas Reg § 301.6111-2(a)(3).

162 Treas Reg § 301.6111-2(a)(3). For more details regarding the meaning of substantially similar and for examples of the application of the term, see Treas Reg § 1.6011-4(c)(4).

163 Several commentators have noted the difficulty of making this determination. See, for example, Sarah B. Lawsky, *Probably? Understanding Tax Law's Uncertainty*, 157 U Pa L Rev 1017, 1040–41 (2009) (concluding that the definition of substantially similar is deliberately vague in order to preserve the ability of the IRS to make individual judgments regarding the status of specific transactions). Some have criticized the definition of "substantially similar" as vague and overbroad. See Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 UCLA L Rev 1629, 1657–58 (2009) (explaining that substantially similar might really be better understood as just similar).

164 When a taxpayer has a preexisting and valid business purpose, he typically consults a tax adviser on ways to achieve that business purpose in a tax-efficient manner. To the extent that his business purpose is unique, the advice is likely to be unique. Furthermore, transactions with a

is not customized include: (1) the advice was based on a generic prototype;[165] (2) the advice can be used by almost any taxpayer, regardless of the taxpayer's unique economic situation; (3) the adviser made only "subtle and insignificant changes" to a transaction that was presented to another taxpayer;[166] and (4) the advice is currently, or has been, mass marketed. If a court considers these factors and concludes that the transaction in question is likely to be presented in substantially similar form to more than one participant (as opposed to being customized advice), then the transaction does not satisfy the significant purpose requirement in the regulation and is not a tax shelter under the § 6662 definition.[167]

The regulations under the old § 6662 definition suggest that there should be an exception for tax planning that is consistent with the Code and congressional purpose. The regulations for the old § 6111 definition suggest that significant purpose includes only (1) listed transactions and (2) transactions that are presented to multiple participants in substantially similar form. These limits should carry over into courts' analysis of the tax shelter definition in § 6662(d).[168] Because this definition is incorporated into § 7525(b), these limitations will help to ensure that the tax shelter exception does not swallow the rule.

The test articulated above does *not* include nonlisted—but highly abusive—customized tax advice. Realities of the "cat and mouse" nature of the anti-abuse efforts by the IRS make another prong for the test necessary. There is often a lag between the time an abusive

valid business purpose are those most likely to be upheld, so there is little to be gained by labeling such transactions as tax shelters. The existence of a business purpose should thus cut in favor of finding that advice is customized.

165 Consider *Countryside*, 132 Tax Ct at 352–53 (noting that Egan's advice was not based on a generic prototype maintained by his firm).

166 See Modification of Tax Shelter Rule III, TD 9000, 2002-2 Cumulative Bull 87, 88. When the Treasury described the new definition of substantially similar, it explained that its purpose was to prevent taxpayers from trying to evade reporting requirements by making only minor changes to listed transactions and then claiming that they were not, in fact, listed transactions. Id ("[S]ome taxpayers and promoters have made subtle and insignificant changes to a listed transaction in order to claim that their transactions are not subject to disclosure.").

167 A recent tax court opinion recognized the significance of whether advice is customized or marketed. In *106 Ltd v Commissioner of Internal Revenue*, 2011 WL 80446 (Tax Ct), the court considered the meaning of promoter in determining good-faith reliance for the § 6664(c) understatement penalty exception. Id at *6–9. The court noted both the broad definition of promoter from *Tigers Eye Trading, LLC v Commissioner of Internal Revenue*, 97 Tax Ct Mem Dec (CCH) 1622 (2009), see note 129, and the narrow, relationship-based definition of promoter from *Countryside*. The court determined that the broader definition from *Tigers Eye* was appropriate for good-faith reliance cases where "the transaction involved is the same tax shelter offered to numerous parties." *106 Ltd*, 2011 WL 80446 at *27–28. The court thus implied that where tax advice was not marketed, *Countryside*'s narrower, relationship-based definition of promoter might be more appropriate. See id.

168 See text accompanying notes 150–56.

transaction begins to be utilized and the time that the IRS lists that transaction.[169] The IRS is always trying to keep up with cutting edge tax planning, and tax advisers are always looking for new ways to save their clients money. For this reason, the § 6662 tax shelter definition—and by extension, the tax shelter exception—should also apply if the judge can easily tell that the claimed tax benefits are unmistakably inconsistent with the Code and with congressional purpose. This may be thought of as a safety valve, allowing a court to find that the tax shelter definition is satisfied for especially egregious tax planning that does not (yet) meet the formal requirements of the rules in the regulations.

The judge would have to be able to make this determination early on in litigation proceedings, before the court has had a chance to fully investigate all of the details. Because this test will be used to rule on a privilege claim, it must remain relatively simple to administer, and it should not depend on the ultimate merits of the case.[170] Thus, this aspect of the test comes into effect only where the judge can easily make this determination early on, when the privilege questions arise. When tax planning is so abusive that the judge can easily see that it is inconsistent with congressional purpose, the significant-purpose definition will be satisfied, regardless of whether the transaction is listed or the advice is customized.[171]

This third element, combined with aspects gleaned from the two Treasury regulations, creates a robust test for the definition of tax shelter. The test can be articulated as follows:

> A transaction will satisfy the § 6662(d) tax shelter definition—and therefore be a tax shelter for purposes of § 7525(b)—if it is (1) a listed transaction, or (2) the tax adviser reasonably expects to present the same or a substantially similar transaction to at least one other taxpayer, or (3) the judge can identify the transaction as clearly abusive without a rigorous examination of all of the facts. The definition will *not* be satisfied if a judge can

169 See, for example, S Prt No 108-34 at 7 (cited in note 28).

170 See *United States v BDO Seidman, LLP*, 2005 WL 742642, *9 (ND Ill) (recognizing the difficulty of making early determinations on whether a transaction is a tax shelter).

171 Importantly, this "safety valve" may be easier to administer due to the huge lag between audits and litigation. For instance, in 2010 a taxpayer may engage in an egregious transaction. It may not get audited until 2012, and litigation may not start until 2014. In that time, the transaction may have become a listed transaction or commentary on the transaction may note its egregious nature. It therefore might not be so hard for a court to make such a determination. For example, the transactions in *Countryside* took place in 2000, and the IRS first officially challenged the distributions in 2004. *Countryside v Commissioner of Internal Revenue*, 95 Tax Ct Mem Dec (CCH) 1006, 1007–08 (2008).

> readily determine that the claimed tax benefits are consistent with the Code and with congressional purpose.[172]

Although one might question the validity of combining these regulations, some clear line must be drawn if tax advisers are to derive any benefit from the privilege.[173] This line has the benefit of being good policy by targeting the most abusive types of tax planning and, at the same time, retaining a meaningful and predictable privilege. It targets the most abusive practices by disfavoring listed transactions and generic advice. The listed transactions have already been identified by the IRS as potentially abusive,[174] so there is no question that the goals of the tax shelter exception are being furthered by reaching them. Furthermore, in the aggregate, generic advice may be more abusive than customized advice due to the sheer volume of taxpayers that can be reached through mass marketing.[175]

Furthermore, this definition of significant purpose would allow the tax shelter exception to focus on the types of abusive practices specifically occurring in the late 1990s. The mass market for corporate tax shelters was at its peak at this time.[176] It is reasonable to assume that a major goal of the creation of the tax shelter exception was to ensure that the creation of the privilege did not hinder the IRS's efforts to combat this mass market for abusive transactions. Under the proposed test, the tax shelter exception would satisfy this goal by reaching all marketed tax shelters (unless a judge determined that the tax benefits were consistent with the Code and congressional intent).

This Comment's test for the significant-purpose definition of tax shelter should be adopted and applied to the § 7525(b) privilege exception because it is relatively simple to apply, it is predictable, and

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172 This test resembles *Countryside*'s rule shielding communications from long-term advisers giving custom advice, but this test is more robust. Like the *Countryside* rule, this test exempts a great deal of customized advice from the tax shelter exception. Consider *Countryside*, 132 Tax Ct at 354–55 (noting that the advice from Egan was given in response to a specific request and as part of an ongoing relationship). This new test, however, includes a bright-line rule that does not privilege advice regarding listed transactions and transactions that are clearly abusive, regardless of the length or quality of the advising relationship.

173 See note 16.

174 See note 23.

175 S Rep No 108-34 at 57 (cited in note 28) (describing KPMG's marketing tactics and ability to make contacts across the country). It is true that customized advice can be highly abusive. See Beale, 25 Va Tax Rev at 596–97 (cited in note 25). The test for the tax shelter exception, however, must be easy to administer early in litigation. Any test that regularly considered customized advice would probably have to look in great detail at the overall merits of the transactions, and it would be difficult to predict with any certainty the outcome of any particular privilege claim. This Comment's proposed test allows some customized abusive practices to retain privilege—but only those that are not clearly abusive—so that it can be administered predictably.

176 See S Prt No 108-34 at 4 (cited in note 28).

it targets the most abusive types of planning.[177] The district court in *Valero* rejected this more nuanced approach, concluding that the government need not make any showing regarding the substance of the transactions to satisfy the significant-purpose definition.[178] That approach should be rejected. This would allow courts to ensure that the § 6662 definition—and by extension, the § 7525(b) exception—is not applied to routine and customized tax planning.

C. Summary and Application: What Is Tax Shelter Promotion?

This section summarizes the Comment's assertions by setting forth the method that courts should follow to determine whether there was promotion of participation in a tax shelter. First, the judge must ask whether there was promotion. The relevant question is whether, in the communications at issue, the tax practitioner encouraged or facilitated the taxpayer's efforts to participate in the alleged tax shelters. This requirement will be satisfied any time a tax professional helps a taxpayer plan or carry out a transaction—consequently, this is often a very easy standard to meet. The length of the advising relationship, and whether the advice was custom tailored (as opposed to generic and prepackaged), will not factor into this initial question.

Second, if there was promotion, the judge should examine the substance of the transactions to see whether they fall within § 6662(d)'s definition of tax shelter. This depends on whether a

177 Furthermore, this limiting approach is consistent with the way that most courts have dealt with the § 6662 tax shelter definition. As stated above, no court has explained the meaning of significant purpose, see note 136 and accompanying text, but courts have established a pattern of finding a significant purpose only where the tax shelter was abusive. Although on its face the § 6662 definition deals only with motives, courts have often also looked at the underlying substance of the transaction when concluding that it was a tax shelter. See, for example, *Jade Trading, LLC v United States*, 80 Fed Cl 11, 57 (2007) ("[A]n objective scrutiny of the spread transaction contributed to Jade leads ineluctably to the conclusion that the spread transaction wholly lacked economic reality and concomitantly that tax avoidance was a significant purpose of this transaction."); *Santa Monica Pictures, LLC v Commissioner of Internal Revenue*, 89 Tax Ct Mem Dec (CCH) 1157, 1229 (2005) ("We have concluded that the transaction . . . had no economic substance, its only purpose being to transfer built-in tax losses in exchange for a $10 million cash payment. Consequently, this arrangement is considered a 'tax shelter' for purposes of section 6662(d)(2)(C)(iii)."). This pattern shows that (lack of) substance often matters—the courts did not simply ask whether tax avoidance was a "significant" motivation. Two opinions seem to have concluded that the definition was satisfied based only on the taxpayer's motivations, but their exact reasoning is unclear. See *Enbridge Energy Co v United States*, 354 Fed Appx 15, 22 (5th Cir 2009) (holding that the taxpayer could not avoid § 6662 penalties because the transaction was "motivated solely by the avoidance of taxes"); *Doe v Wachovia Corp*, 268 F Supp 2d 627, 637 (WD NC 2003) (holding that the § 7525 privilege did not apply because "the tax opinion sold to the Plaintiffs clearly shows the transaction was designed to be a tax advantaged structure").

178 See text accompanying notes 137–42.

significant purpose of the transactions was to avoid or evade income taxes. Because no clear definition of significant purpose has been articulated by the courts, this Comment has proposed a test based roughly on the Treasury regulations, as discussed in Part III.B.2. Applying that test, a judge would first ask whether the transaction is consistent with the Code and congressional intent (without delving too deeply into the disputed or unclear facts). If it is, then the transaction is not a tax shelter. But if it is not, or if this determination cannot be made, then the judge should determine whether the transaction is a listed transaction. If so, then it is a tax shelter. If not, then the judge should ask whether the advice is generic advice that will reasonably be presented in the same or substantially similar form to at least one other taxpayer. If so, then the transaction is a tax shelter. If, after applying this standard, the judge determines that the tax shelter definition is not satisfied, then the § 7525 privilege may protect the communications because the adviser was not engaged in tax shelter promotion.[179]

Even though this Comment attempts to create a test that is easy to administer, application of the test will be difficult because a judge must rule on claims of privilege in the early stages of litigation.[180] Whether a given transaction was an abusive tax shelter is often the ultimate question in the case. This aspect of early decisionmaking is, of course, not a new problem. The crime–fraud exception to the attorney–client privilege pierces the privilege for communications made for the purpose of assisting the client to engage in fraud or to commit a crime, and judges must make decisions on these matters prior to the ultimate disposition of the case.[181] For procedural details

179 Because the tax practitioner privilege adopts the same protections of the common law attorney–client privilege, the crime–fraud exception applies when analyzing the tax practitioner privilege. See *BDO Seidman*, 492 F3d at 822; text accompanying note 51. Because Congress is presumed not to have created a superfluous exception in § 7525(b), we would expect a correct interpretation of the tax shelter exception to apply to certain kinds of aggressive tax planning that are not reached by the crime–fraud exception.

This Comment's interpretation preserves such a distinction. Former IRS Chief Counsel John Williams stated that aggressive tax planning and mass-marketed tax shelters would "rarely, if ever," rise to the level of tax advice that would be subject to the crime–fraud exception. John B. Williams, *Speech to NYSBA Tax Section Meeting*, 2003 Tax Notes Today 15-20, ¶¶ 9–23 (Jan 23, 2003). But see *BDO Seidman*, 492 F3d at 818 (applying a broader standard than that advocated by Chief Counsel Williams and finding that advice regarding mass-marketed tax shelters could fall under the crime–fraud exception). Predicting the exact amount of overlap between the two exceptions is difficult, because application of the crime–fraud exception is not entirely consistent. See William H. Volz and Theresa Ellis, *An Attorney–Client Privilege for Embattled Tax Practitioners: A Legislative Response to Uncertain Legal Counsel*, 38 Hofstra L Rev 213, 225–26 (2009).

180 See note 170.

181 See *In re Antitrust Grand Jury*, 805 F2d 155, 164 (6th Cir 1986).

and burdens of proof, courts should apply the tax shelter exception in the same way they apply the crime–fraud exception.[182]

Nonetheless, because the question will arise long before a judge would normally rule on the merits, the result may ultimately hinge on the judge's early intuitions about the transactions. Thus, the tax shelter exception may yet encompass some legitimate planning. But, under this Comment's proposed test, the exception will generally not conflict with planning that is customized or is so routine that the judge can readily identify it as nonabusive. Until the § 6662 significant-purpose language is clarified, either by amending the Code or through new Treasury regulations, this is the best that courts can do.

It is illustrative to consider how this method would have applied in *Countryside* and *Valero*. If this test had been applied in *Countryside*, there is a strong possibility that the court would have arrived at the same result, but in a much different way. There was "promotion" because Egan helped arrange the transactions. The court would have moved on to consider whether the transaction was a tax shelter under the § 6662(d) definition. The transactions in *Countryside* were not listed transactions, and they were neither clearly inconsistent nor clearly consistent with the Code and congressional intent.[183] The court commented on whether the advice was customized:

> [Egan] did not rely on any generic prototypes, descriptive materials, or files maintained by [PricewaterhouseCoopers (PWC)]. He had recourse to tax specialists in the PWC national office in Washington, D.C., who help[ed] him understand complex provisions of the Internal Revenue Code and associated regulations, but he received from them no descriptive materials regarding the tax structure in issue here.[184]

The court was therefore convinced that this advice was not the type that would reasonably be presented in substantially similar form to multiple taxpayers. Furthermore, almost one year earlier, the same judge had determined that Countryside's liquidating transactions had

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182 See *BDO Seidman*, 492 F3d at 822 (using this approach). The party seeking to abrogate the privilege must show some foundation in fact that the exception applies. The court will then request a response or explanation from the party seeking privilege regarding why the privilege should still apply. Id. The process frequently involves in camera review of the challenged documents. The required standard of proof may vary, but generally a preponderance of the evidence standard is used if the documents are reviewed in camera. See Christopher B. Mueller and Laird C. Kirkpatrick, *Evidence* § 5.22 at 370–71 (Aspen 4th ed 2009). See also notes 51, 179, and accompanying text.

183 Although one year earlier the judge had upheld certain aspects of the transaction, the IRS raised other challenges to the transactions that were proceeding in other courts. See *Countryside*, 95 Tax Ct Mem Dec (CCH) at 1014.

184 *Countryside*, 132 Tax Ct at 352–53.

a business purpose.[185] The fact that the transactions had a real business purpose and the advice was given at the taxpayer's request strengthens the claim that the advice was customized. Thus, the court would likely have determined that the tax shelter exception did not apply because the transaction in question was not a tax shelter under the § 6662 "significant purpose" definition.

In *Valero*, the Seventh Circuit properly concluded that there was promotion. The court affirmed the district court's decision that the transaction was a tax shelter—yet this decision did not carefully consider the substance of the transaction.[186] Had the court applied this Comment's proposed test for the definition of tax shelter, the court might have determined that the transaction was clearly abusive. Although this was not a listed transaction, the court considered evidence that it might in fact be very abusive. The court criticized all four of the purported business purposes put forth by the taxpayer, and evidence suggested that the business purposes were manufactured to attract less attention from the IRS.[187] If the court could have determined that the transaction was obviously abusive, then it would have found that the tax shelter exception applied. Alternatively, the court could have found that the tax shelter exception applied if the tax advice was expected to be presented to multiple taxpayers. There was some evidence that the advice was not customized and that a similar strategy had been used by other Arthur Andersen clients.[188] Under this Comment's proposed test, the court would have had to consider this evidence more carefully.

CONCLUSION

The value of the tax practitioner privilege will be severely limited until taxpayers and their advisers can predict how the privilege will apply in long-term advising relationships. Courts should ignore the length of the advising relationship, and should read promotion broadly to mean furtherance or encouragement—consistent with the way similar terms are used in other Code provisions pertaining to tax shelters. Additionally, courts should recognize that the § 6662 tax

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185 See *Countryside*, 95 Tax Ct Mem Dec (CCH) at 1021–22.

186 See text accompanying notes 137–42.

187 *Valero*, 2008 WL 4104368 at *15–16 ("It appears to the Court that the tax avoidance objective for the step plan preceded whatever business purposes Andersen later developed, not the other way around.").

188 See Brief for the Appellee, *Valero Energy Corp v United States*, No 08-3473, *32 n 9 (7th Cir filed Dec 15, 2008) (available on Westlaw at 2008 WL 5789494) ("[E]vidence in the record indicates that at least some of the strategy imparted to Valero by Andersen was also a strategy that Andersen shared with another client.").

shelter definition should be limited to listed transactions, nonlisted transactions that are prepared for multiple taxpayers, and transactions that are clearly abusive. It does not encompass any transaction in which the claimed tax benefits are consistent with the Code and congressional purpose. Armed with this narrower understanding of tax shelter and this broader understanding of promotion, courts can ensure that the exception reaches abusive tax planning without interfering with routine and customized tax advice.