THE TROUBLE WITH TARGETING TAX SHELTERS

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Abusive tax shelters—complex transactions that produce tax benefits Congress never intended, but that may resemble legitimate business deals—frequently escape Internal Revenue Service (IRS) detection. For the past twenty years, the federal government has attempted to bolster the IRS's ability to detect these transactions by requiring taxpayers and their advisors to disclose "reportable transactions" to the IRS Office of Tax Shelter Analysis. These mandatory disclosure rules can serve valuable tax enforcement functions, such as deterring abusive tax planning. However, these rules are also subject to significant limitations, especially when applied to high-income and wealthy taxpayers who have access to sophisticated legal counsel. In July 2021, the U.S. Supreme Court introduced an additional potential obstacle as a result of its decision in CIC Services, LLC v. Internal Revenue Service—the reportable transaction rules may now be subject to preemptive administrative law challenges without being barred by the Anti-Injunction Act.

This Article argues that in the wake of CIC Services, policymakers should look beyond simply reforming the IRS's process of issuing tax shelter notices to avoid potential administrative law challenges. Instead, they should reconsider more generally the government's primary reliance on "activity-based rules" to combat abusive tax planning. This Article brings new perspective to the challenges of targeting tax shelters and explains how they result from the government's activity-based approach.

To complement this activity-based approach, this Article describes how the government should also incorporate an "actor-based" approach to combating abusive tax planning, which would adjust the tax compliance rules based on the economic circumstances of the taxpayers, rather than solely as a result of their activities. High-income and wealthy taxpayers could be subject to adjusted tax compliance rules, such as higher tax penalties,

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longer statutes of limitation, narrower penalty defenses, or additional information reporting obligations. This actor-based approach offers specific advantages following the decision in CIC Services and can be coordinated with the current reportable transaction rules to provide a more robust and comprehensive approach to combating abusive tax planning.

INTRODUCTION

Abusive tax shelters—complex transactions that produce tax benefits Congress never intended, but that may resemble legitimate business deals—frequently escape detection and challenge by the Internal Revenue Service (IRS). For the past twenty years, the federal government has attempted to bolster the IRS's ability to detect these transactions by requiring taxpayers and their advisors to disclose participation in "reportable transactions" to the IRS Office of Tax Shelter Analysis.[1] While mandatory disclosure rules can serve valuable tax enforcement functions, including deterrence of abusive tax planning, they are also subject to significant limitations, especially when applied to high-income and wealthy taxpayers who have access to

1. Treas. Reg. § 1.6011–4(b) (2007). Taxpayers are required to disclose the details of reportable transactions in which they participate by filing an Internal Revenue Service (IRS) Form 8886, Reportable Transaction Disclosure Statement, with the IRS Office of Tax Shelter Analysis in Ogden, Utah. *See* Treas. Reg. § 1.6011–4(d) (2007). Tax advisors that qualify as material advisors are required to file IRS Form 8918, which bears similar information. *See* Treas. Reg. § 301.6111–3(d)(1). See *infra* Section I.A for a description of the reportable transaction regime.

sophisticated legal counsel.[2] In July 2021, in *CIC Services, LLC v. Internal Revenue Service*,[3] the U.S. Supreme Court introduced an additional potential obstacle to the mandatory tax shelter disclosure rules, which may now be subject to preemptive administrative law challenges.[4]

In *CIC Services*, the Court unanimously held that a suit challenging an IRS notice identifying a reportable transaction was not barred by the Anti-Injunction Act (AIA), which generally requires a taxpayer to first pay the tax before filing a legal challenge.[5] The plaintiff in the case—a tax advisor who specialized in advising clients on micro-captive insurance strategies—attempted to prevent the IRS from enforcing a "transaction of interest" notice by arguing that the agency did not comply with the notice-and-comment process required by the Administrative Procedure Act (APA).[6] Regardless of whether the IRS or the plaintiff ultimately prevails on the merits of the underlying APA challenge,[7] the Supreme Court's holding in *CIC Services* highlights an additional legal hurdle in the government's ongoing efforts to address abusive tax shelters.

Rules such as the reportable transaction disclosure requirements, including associated tax penalties for nondisclosure, reflect an "activity-based" approach to tax enforcement.[8] These rules target specific activities and transactions that may be abusive.[9] The activity-based approach is an important and necessary feature of the government's tax enforcement strategy, but it faces significant limitations when it is the primary or only response to abusive tax shelters and other forms of noncompliance.[10] Activity-based rules, such as the reportable transaction rules, are usually implemented in response to emerging tax avoidance schemes rather than preemptively to deter abusive tax planning in general.[11] When the IRS designates a specific transaction as a "listed transaction" or a "transaction of interest," taxpayers and their advisors may respond by pursuing other tax avoidance strategies that do not fit into these

2. *See* discussion *infra* Section II.A.

3. 141 S. Ct. 1582 (2021).

4. *Id.* at 1592–94.

5. *See id.*; I.R.C. § 7421(a).

6. *See CIC Servs., LLC*, 141 S. Ct. at 1588.

7. For discussion of the subsequent consideration of *CIC Services*'s underlying challenge in the lower courts, see *infra* notes 73–74 and accompanying text.

8. *See Disclosure of Loss Reportable Transaction*, IRS, https://www.irs.gov/businesses/disclosure-of-loss-reportable-transactions (last visited Feb. 10, 2022).

9. *See, e.g.*, *CIC Servs., LLC*, 141 S. Ct. at 1587 (explaining the evasive nature of "micro-captive transactions" at issue in *CIC Services*).

10. *See* Joshua D. Blank & Ari Glogower, *Progressive Tax Procedure*, 96 N.Y.U. L. REV. 668, 697–700 (2021).

11. *Id.* at 699–700.

designations.[12] High-income and wealthy taxpayers in particular have pursued other tax haven strategies, including pass-through entities such as partnerships and subchapter S corporations, in-kind wealth transfers, cryptocurrency investment, and low valuations of contributions to Roth IRAs and other tax-deferred retirement accounts.[13]

In addition to the federal government's limited ability to identify and deter abusive tax planning, the reportable transaction rules now face additional risks arising from the government's primary reliance on an activity-based approach to tax shelter enforcement. Because abusive tax transactions often evolve and spread undetected, the IRS often has to issue tax shelter notices quickly in response to changing taxpayer strategies.[14] After *CIC Services*, taxpayers may preemptively challenge both past and future listed transactions and transaction of interest notices under the APA without being barred by the AIA.

Some have argued that the current IRS procedures are fully compliant with the APA,[15] while others have proposed administrative law remedies that the IRS could adopt in response to *CIC Services*, such as publishing these notices in the *Federal Register* and allowing the public time to submit comments.[16] In all events, however, *CIC Services* introduces new potential obstacles and legal risks which can further impair the ability of the IRS to implement the reportable transaction rules.

This Article argues that in the wake of *CIC Services*, policymakers should look beyond simply reforming the IRS's process of issuing tax shelter notices to avoid potential administrative law challenges. Instead, they should reconsider the government's primary reliance on activity-based rules to combat abusive tax planning more comprehensively.[17] This Article brings a new perspective to the challenges of targeting tax shelters and explains how tax shelters result from the government's activity-based approach. To complement this activity-based approach, we argue that the government should also incorporate an "actor-based" approach to combating abusive tax planning, which would adjust the tax compliance rules based on the economic circumstances of the taxpayers, rather than solely as a result of their activities.[18]

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12. *See* Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 UCLA L. REV. 1629, 1638 (2009).

13. *See infra* note 108 and accompanying text.

14. *See infra* note 56 and accompanying text.

15. *See, e.g.*, Lee A. Sheppard, *Successful Challenges to IRS Guidance After* CIC Services*?*, 171 TAX NOTES 1349, 1353–55 (2021); *see also infra* note 78 and accompanying text.

16. *See, e.g.*, Daniel Hemel, *Treasury Needs To Act Fast To Save the Tax-Shelter Disclosure Regime*, SUBSTANCE OVER FORM (May 18, 2021), https://substanceoverform.substack.com/p/treasury-needs-to-act-fast-to-save; *see also* text accompanying notes 80–81.

17. *See infra* Part II.

18. *See infra* Section II.C.

High-income and wealthy taxpayers could be subject to adjusted tax compliance rules such as higher tax penalties, longer statutes of limitation, narrower penalty defenses, or additional information reporting obligations.

Our prior work introduced a general case for actor-based adjustments to the tax compliance rules.[19] This Article builds upon this framework with three related arguments. First, the Article describes the specific advantages of actor-based adjustments in the context of the tax shelter reporting rules, and how they may be implemented. Second, the Article provides a new perspective on actor-based adjustments in this context by considering their advantages following *CIC Services* and limitations on activity-based rules implemented through agency action. This consideration also describes a previously unappreciated linkage between the government's reliance on activity-based rules and administrative law challenges to tax enforcement. Finally, the Article describes how this actor-based approach can be coordinated with the current reportable transaction disclosure requirements to provide a more robust and comprehensive response to abusive tax planning.

Part I of this Article describes the reportable transaction regime and its limitations, including its vulnerability to preemptive administrative law challenges following *CIC Services*. Part II presents an alternative model for confronting abusive tax planning that incorporates an actor-based approach into the reportable transaction framework. Part II.C then compares the efficacy of this new model to the government's current primary reliance on activity-based rules in light of *CIC Services*.

I. THE LIMITATIONS OF TARGETING ABUSIVE ACTIVITIES: REPORTABLE TRANSACTIONS

The Supreme Court's decision in *CIC Services* creates new obstacles to the IRS's implementation of the reportable transaction disclosure rules. After *CIC Services*, taxpayers and their advisors may seek to enjoin the IRS from requiring taxpayers to disclose information about specific tax strategies, without the obstacle of the AIA in the way, by arguing that the IRS has not complied with the requirements of the APA when designating these strategies as listed transactions and transactions of interest.[20] Irrespective of the legal validity of these claims, even the potential for injunctions against the IRS would undermine one of the key purposes of the reportable transaction disclosure rules, which is to enable the IRS to detect potentially abusive tax shelter activities.[21] This Part describes the specific activities that the reportable transaction regime subjects to

19. *See generally* Blank & Glogower, *supra* note 10 (discussing the general advantages of actor-based adjustments to the tax compliance and procedure rules).

20. *See* discussion *infra* Section I.C.

21. *See* discussion *infra* Section I.B.

disclosure, the rationale for these requirements, their general limitations as a response to the use of abusive tax shelters, and the implications of the Supreme Court's decision in *CIC Services* for their implementation.

A. The Reportable Transaction Regime

When taxpayers participate in certain activities that qualify as reportable transactions, they are required to file special disclosure statements with the IRS Office of Tax Shelter Analysis.[22] Tax advisors also must file disclosure statements when they advise taxpayers regarding reportable transactions in exchange for a minimum fee and must maintain a list of these taxpayers, which the IRS may request to review at any time.[23] As described below, the reporting obligations of taxpayers and their advisors depend upon the specific types of activities in which they engage, rather than the characteristics of the actors involved.

Listed Transactions. The most specific types of reportable transactions are listed transactions.[24] When the IRS designates a tax strategy as a listed transaction, the agency states its view that the strategy is abusive because it lacks economic substance or is otherwise inconsistent with congressional intent.[25] As of July 1, 2021, there were thirty-six separate transactions designated as listed transactions by the IRS on its website,[26] including widely used abusive tax strategies such as BOSS (bond and option sales strategy),[27] CARDS (custom adjustable rate debt

22. Taxpayers are required to disclose the details of reportable transactions in which they participate by filing IRS Form 8886, Reportable Transaction Disclosure Statement, with the IRS Office of Tax Shelter Analysis in Ogden, Utah. Treas. Reg. § 1.6011-4(d) (2007); *see also* INT. REV. SERV., *Abusive Tax Shelters and Transactions*, https://www.irs.gov/businesses/corporations/abusive-tax-shelters-and-transactions. For further description, see Blank, *supra* note 12, at 1635–42. Taxing authorities outside the United States have also adopted mandatory disclosure as an approach for addressing abusive tax planning. *See generally* Patricia A. Brown, Victor Jaramillo, Floris Verweijmeren & Diane Ring, *Combating Aggressive Tax Planning Through Disclosure: A Comparison of U.S. and EU Rules Applicable to Tax Advisors*, AM. BAR ASS'N TAX TIMES, June 2019 (highlighting the "information asymmetry" between tax authorities and taxpayers).

23. Tax advisors that qualify as material advisors are required to file IRS Form 8918, which bears similar information. Treas. Reg. § 301.6111–3(d)(1) (2007).

24. Treas. Reg. § 1.6011–4(b)(2).

25. *See, e.g.*, I.R.S. Notice 2001-17, 2001-1 C.B. 730 (describing tax shelter transactions using contingent liabilities).

26. *See Recognized Abusive and Listed Transactions*, INT. REV. SERV. https://www.irs.gov/businesses/corporations/listed-transactions (last visited Feb. 10, 2022) (listing thirty-six transactions in chronological order).

27. I.R.S. Notice 99-59, 1999-52 I.R.B. 761.

structure),[28] and the contingent liability tax shelter strategy.[29] To prevent taxpayers and advisors from avoiding the disclosure requirement by slightly altering their transactions, Treasury regulations also require taxpayers to disclose any tax strategies that are "substantially similar" to listed transactions.[30]

Transactions of Interest. Taxpayers and advisors must also report participation in any transaction of interest or any substantially similar transactions.[31] Unlike listed transactions, which the IRS explicitly describes as abusive, transactions of interest are potentially abusive but Treasury and the IRS "lack enough information" about the structure and purpose of these strategies.[32] For example, in *CIC Services*, the IRS designated the micro-captive insurance tax strategy as a transaction of interest.[33]

Other Reportable Transactions. Reportable transactions also include more general categories of transactions, bearing features that have appeared when tax shelter promoters have marketed tax avoidance strategies to taxpayers.[34] For example, the law requires taxpayers to disclose any transactions where tax advisors guarantee refunds of fees or where tax advisors limit taxpayers' ability to share information about their advice.[35] As another example, taxpayers must disclose any transaction that results in a large tax loss ($10 million in a single year, in the case of corporations, and $2 million in a single year, in the case of individuals).[36] Even if the underlying activity is fully compliant with the law, such as a bona fide tax loss, taxpayers are still obligated to disclose these reportable transactions to the IRS.[37]

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28. I.R.S. Notice 2002-21, 2002-1 C.B. 730.

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

30. Treas. Reg. § 1.6011–4(c)(4). Under the regulations, taxpayers and advisors must disclose any transaction that is "expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy." *Id.* The definition thus sets the threshold for disclosure at whether the transactions or underlying tax strategies are merely "similar." *Id.* For criticism of this standard, see Terence F. Cuff, *Los Angeles Practitioner Comments on Shelter Regs*, 100 TAX NOTES 1059, 1067 (2003) (commenting on deficiencies in the regulations).

31. Treas. Reg. § 1.6011–4(a), (b)(6).

32. T.D. 9350, 2007-38 I.R.B. 607, 608.

33. *See* CIC Servs., LLC v. IRS, 141 S. Ct. 1582, 1587 (2021) (describing micro-captive transactions as "typically an insurance agreement between a parent company and a 'captive' insurer under its control.").

34. *See, e.g.*, Treas. Reg. § 1.6011–4(b)(3) (listing confidentiality clauses as a feature of reportable transactions).

35. Treas. Reg. § 1.6011–4(b)(3), (4).

36. Treas. Reg. § 1.6011–4(b)(5).

37. *See* Treas. Reg. § 1.6011–4(b)(2); H.R. REP. NO. 108-755, at 373, 447 (2004) (Conf. Rep.). For instance, if a taxpayer participates in the contingent liability tax shelter, which the

Penalties. The law contains significant penalties for noncompliance with the reportable transaction disclosure rules. For each act of nondisclosure of a listed transaction, individual taxpayers are charged a $100,000 penalty and corporate taxpayers are charged a $200,000 penalty.[38] These penalties are reduced to $10,000 for individuals and $50,000 for corporations for the nondisclosure of any other type of reportable transaction.[39] Further, where taxpayers' returns show a "reportable transaction understatement," a 20% accuracy-related tax penalty applies.[40] This penalty increases to 30% if the taxpayer failed to disclose the transaction to the IRS.[41] Finally, the law also imposes high monetary penalties on material advisors that fail to comply with the reportable transaction disclosure rules.[42]

B. Purpose and Limitations

The primary objective of the reportable transaction disclosure regime is to empower the IRS to detect and deter abusive tax shelter activity.[43] First, in effect, these rules require taxpayers to raise red flags to the IRS regarding potentially abusive tax strategies underlying the positions that they have claimed on their returns. They are designed to provide IRS agents with an "audit roadmap," enhancing their ability to detect abuse.[44] Second, the reportable transaction rules allow IRS officials to communicate to taxpayers that they view specific transactions as abusive and to describe their reasoning.[45] Third, the reportable transaction disclosure rules, including high penalties for nondisclosure, are structured to deter taxpayers from engaging in abusive tax planning.[46] When the IRS announces that a tax

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IRS has designated as a listed transaction, the taxpayer is obligated to disclose its participation even if it believes that the transaction served a real business purpose unrelated to tax avoidance.

38. I.R.C. § 6707A(b)(2)(A).

39. *Id.* § 6707A(b)(2)(B). These penalties effectively apply on a strict liability basis and "without regard to whether the transaction ultimately results in an understatement of tax." H.R. REP. NO. 108-755, at 596 (2004) (Conf. Rep.).

40. *Id.* § 6662A(a).

41. *Id.* § 6662A(c).

42. If an advisor does not file a reportable transaction disclosure statement regarding a listed transaction, the advisor is subject to a monetary penalty of $200,000 or 50% of the gross income it earned for providing advice regarding the transaction, whichever is greater. I.R.C. § 6707A(b)(2)(A).

43. *See* Abusive Transactions, Process Guide for Combating Abusive Tax Avoidance Transactions, IRM 4.32.1 (Oct. 12, 2021) (describing purposes of reportable transaction rules).

44. *See* Blank, *supra* note 12 at 1635–42 (2009); *see also* Ronald A. Pearlman, *Demystifying Disclosure: First Steps*, 55 TAX L. REV. 289, 294–98 (2002) (describing audit efficiency as one of the prime rationales for enhanced tax shelter disclosure).

45. *See* Abusive Transactions, IRM 4.32.1, *supra* note 43.

46. I.R.C. § 6707A.

strategy is a listed transaction or transaction of interest, market demand for that strategy among taxpayers typically ceases.[47]

Despite their important role in tax enforcement, the reportable transaction rules also encounter significant limitations as a comprehensive response to the problem of abusive tax shelters. In the case of the disclosure requirements for listed transactions and transactions of interest, the rules are necessarily reactive rather than proactive. For example, in many of its listed transaction notices, the IRS states it has "become aware of certain types of transactions . . . that are being marketed to taxpayers for the avoidance of federal income taxes,"[48] emphasizing that it is issuing the notice in response to growing use of a tax avoidance strategy. By the time the IRS issued its listed transaction notice regarding the contingent liability tax shelter, hundreds of taxpayers had already used this strategy.[49]

Further, when the IRS attempts to require taxpayers to submit information about a specific abusive tax shelter, there is a risk that the agency will define the strategy in terms that are either too narrow or too broad to result in effective disclosure.[50] For this reason, Treasury includes the substantial similarity requirement, instructing taxpayers to interpret it broadly.[51] A collateral consequence of this requirement, however, is that taxpayers may provide information about transactions that are not abusive.[52] For instance, in response to the IRS's listed transaction notice regarding notional principal contracts, the agency received a "flood of disclosures" regarding non-abusive total return equity swaps.[53] When the IRS receives disclosure statements regarding complex transactions that lack tax avoidance motivation, its agents must investigate and distinguish these transactions from those that are abusive. This distraction slows the IRS's investigations of truly abusive transactions and delays statutory responses

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

48. *See, e.g.*, I.R.S. Notice 2001-16, 2001-1 C.B. 730 (intermediary corporation tax shelter).

49. *See* Richard M. Lipton, *New Tax Shelter Decisions Present Further Problems for the IRS*, 102 J. TAXATION 211, 211–17 (2005) (describing IRS cases targeting corporate tax shelters).

50. For further discussion, see Blank, *supra* note 12.

51. *See* Crystal Tandon, *Too Many Unlisted Transactions Being Reported, IRS Officials Say*, 113 TAX NOTES 203, 203–04 (2006) (quoting Christopher B. Sterner—IRS division counsel for the Large and Midsize Business Division—as stating to tax practitioners: "If I were in your shoes and I wasn't sure, I would disclose . . . ").

52. *See* Blank, *supra* note 12, at 1642.

53. *See* Tandon, *supra* note 51, at 203. In 2006, the IRS conceded that its notice had "caused taxpayers to file large numbers of disclosure statements on Form 8886, Reportable Transaction Disclosure Statement, for common transactions, such as total return swaps, that are entered into for bona fide non-tax purposes." I.R.S. Notice 2006-16, 2006-9 I.R.B. 538.

to tax avoidance strategies. Further, taxpayers and their advisors expend time and resources preparing and filing unnecessary disclosure statements.[54] Lastly, as a result of their focus on specific activities, the reportable transaction rules generally necessitate administrative, rather than legislative, action.[55] Congress usually cannot enact legislation that anticipates or targets specific abusive strategies quickly enough to control their spread. As a result, the IRS relies on listed transaction and transaction of interest notices to designate specific tax strategies as potentially abusive tax shelters.[56] Because the IRS often needs to act quickly through agency action, however, it can also face administrative law challenges to these actions from taxpayers and advisors.

C. CIC Services, LLC v. IRS

In *CIC Services*, a tax advisor in Tennessee who specialized in advising clients regarding micro-captive insurance strategies attempted to prevent the IRS from requiring taxpayers and material advisors to disclose information about this type of tax strategy as a transaction of interest.[57] In these transactions, a taxpayer makes deductible insurance premium payments to a related "captive" insurer, which then makes an election under § 831(b) to exclude the premiums from taxable income.[58] The transaction can improperly erode the parties' total taxable income if the arrangement is not a bona fide insurance contract.[59] The issuance of IRS Notice 2016-66 (Notice 2016-66), which designated these strategies as transactions of interest,[60] imposed reporting obligations on taxpayers participating in these transactions and their material advisors, both of whom faced potential penalties for noncompliance.[61]

54. *See* INTERNAL REVENUE SERV. ADVISORY COUNCIL, PUBLIC MEETING BRIEFING BOOK 11–12 (2006), http://www.irs.gov/pub/irs-utl/2006_irsac_public_meeting.pdf (discussing tax compliance burden); Dustin Stamper & Sheryl Stratton, *Guidance Coming on New Shelter Rules, Says Treasury Official*, 105 TAX NOTES 785, 785 (2004).

55. *See, e.g.*, *Recognized Abusive and Listed Transactions*, *supra* note 26.

56. For a discussion of this feature of the reportable transaction rules, see Tax Section, N.Y. State Bar Ass'n, Report No. 1126, Report on Proposed Regulations Amending the Reportable Transaction Disclosure and List Maintenance Rules 6 (2007).

57. *Id.* at 2–5; CIC Servs., LLC v. IRS, 141 S. Ct. 1582, 1586–88 (2021).

58. *Id.* at 1586–87.

59. For further discussion, see Charlene D. Luke, *Captivating Deductions*, 46 HOFSTRA L. REV. 855, 866–68 (2018) (discussing micro-captive insurance strategies).

60. I.R.S. Notice 2016-66, 47 I.R.B. 745 (Nov. 1, 2016).

61. For a discussion of the consequences from characterizing these strategies as transactions of interest, see *supra* Section I.A.

Prior to Notice 2016-66's first reporting deadline, CIC Services filed a complaint claiming that the notice was invalid under the APA.[62] The petitioner argued that the issuance of the notice was subject to the APA's "notice-and-comment" procedures for "legislative" rulemaking.[63] The government argued that the suit was premature since the AIA bars any "suit for the purpose of restraining the assessment or collection of any tax."[64] Under this Act, plaintiffs must instead pay the tax liability due and then seek a refund from the IRS.[65] The lower courts rejected CIC Services' argument, finding that the AIA applied.[66]

On May 17, 2021, the Supreme Court reversed the appellate court's holding and issued a unanimous decision in favor of the tax advisor in *CIC Services*.[67] The Court held that the petitioner's pre-enforcement suit to enjoin the IRS Notice designating a transaction as a reportable transaction was not barred by the AIA, even though noncompliance with the Notice could result in a tax penalty.[68]

In issuing its decision, the Court provided three reasons for its holding that the suit did not violate the AIA.[69] First, the Court found that the IRS Notice imposed an affirmative reporting obligation, inflicting costs separate from the statutory tax penalty, such as the "hundreds of hours of labor" necessary to comply with the reporting requirement.[70] Second, the Court found that the required reporting by taxpayers and tax advisors and the potential statutory

62. Complaint at 9–11, CIC Servs., LLC v. IRS, No. 3:17-cv-110, 2017 WL 5015510 (E.D. Tenn. Mar. 27, 2017).

63. *Id.*, *applying* Administrative Procedure Act, 5 U.S.C. § 553.

64. Memorandum in Support of the Defendant's Motion to Dismiss at 12, CIC Servs., LLC v. IRS, No. 3:17-cv-110, 2017 WL 5015510 (E.D. Tenn. May 30, 2017) (quoting Anti-Injunction Act, I.R.C. § 7421).

65. I.R.C. § 7421(a).

66. CIC Servs., LLC v. IRS, No. 3:17-cv-110, 2017 WL 5015510, at *4 (E.D. Tenn. Nov. 2, 2017), *aff'd*, 925 F. 3d 247 (6th Cir. 2019), *rev'd*, 141 S. Ct. 1582 (2021).

67. *CIC Servs., LLC*, 141 S. Ct. 1582 (2021). For further discussion of the case and its consequences, see Kristen A. Parillo, *Supreme Court's* CIC Services *Opinion Clarifies Scope of AIA*, TAX NOTES TODAY FED., https://www.taxnotes.com/tax-notes-today-federal/litigation-and-appeals/supreme-courts-cic-services-opinion-clarifies-scope-aia/2021/05/18/60lcw (May 18, 2021); Hemel, *supra* note 16; Sheppard, *supra* note 15.

68. *CIC Servs., LLC*, 141 S. Ct. at 1593–94.

69. *Id.* at 1591–92. The Court's holding in *CIC Services* is generally consistent with the arguments presented by Professor Kristin Hickman in her amicus brief in this case. *See* Brief of Amicus Curiae Professor Kristin E. Hickman in Support of Petitioners, CIC Servs., LLC v. IRS, 141 S. Ct. 1582 (2021) (No. 19-930). For critiques of the Supreme Court's reasoning, see Sheppard, *supra* note 15, at 1351–53; Bryan Camp, *Supreme Court Reverses the Sixth Circuit in* CIC Services – *Viewpoint*, PROCEDURALLY TAXING (May 17, 2021), https://procedurallytaxing.com/supreme-court-reverses-the-sixth-circuit-in-cic-services/.

70. *CIC Servs., LLC*, 141 S. Ct. at 1591.

tax penalty for noncompliance were several steps removed from one another, casting doubt on the characterization of the reporting requirement as a tax.[71] Third, the Court found that the potential criminal penalty resulting from noncompliance with the reporting requirement negated the argument that the IRS Notice involved a tax.[72]

Soon after the Supreme Court's ruling, CIC Services filed a preliminary injunction in the District Court for the Eastern District of Tennessee prohibiting enforcement of Notice 2016-66 pending a trial on the merits.[73] In September 2021, the District Court granted CIC Services' motion, finding that it is "likely to succeed on its claim that Notice 2016-66" is invalid.[74]

D. Implications for Tax Enforcement

CIC Services presents new legal hurdles and risks for the IRS in its efforts to implement the reportable transaction disclosure rules. After *CIC Services*, taxpayers and their advisors may be able to bring APA challenges to IRS notices designating transactions as listed transactions or transactions of interest before paying any applicable taxes or penalties.[75] The lifting of the AIA bar in the context of reportable transaction notices is significant because otherwise taxpayers or advisors would have to first incur tax penalties for noncompliance before bringing a legal challenge.

Furthermore, as in the case of *CIC Services*, taxpayers and tax advisors may also seek preliminary injunctions to prevent notices from going into effect even before a trial on the merits of the claim.[76] If petitioners are successful in enjoining the IRS from enforcing reportable transaction notices, the IRS may be unable to effectively detect and deter abusive tax strategies by designating them as reportable transactions through its current procedures.

The question before the Supreme Court in *CIC Services* concerned the scope of the AIA, but not the petitioner's underlying claim that the IRS violated the APA in issuing Notice 2016-66.[77] Commentators disagree on whether CIC or the IRS is likely to prevail on this substantive question.

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71. *Id.*

72. *Id.* at 1591–92.

73. CIC Servs., LLC v. IRS, No. 3:17-cv-00110, 2021 WL 4481008, at *1 (E.D. Tenn. Sept. 21, 2021); *see also* Kristen A. Parillo, CIC Services *Dispute Returns to Court*, 172 TAX NOTES FED. 843 (Aug. 2, 2021) (summarizing case).

74. *CIC Servs., LLC*, 2021 WL 4481008, at *5; *see also* Benjamin Guggenheim, *IRS Likely Failed to Observe Procedural Rule in* CIC*, Court Says*, 172 TAX NOTES FED. 2230 (Sept. 27, 2021) (discussing the court's rationale for granting the injunction).

75. *See* Hemel, *supra* note 16; Brief of Prof. Hickman, *supra* note 69.

76. *See* Hemel, *supra* note 16.

77. *CIC Servs., LLC*, 141 S. Ct. at 1586.

Some argue that the IRS's current process is compliant with the APA,[78] while others suggest that it would be challenging for the IRS to argue the APA does not require a notice-and-comment period for reportable transactions notices.[79] Even an uncertain outcome, however, introduces additional risk to the IRS's current efforts to implement the reportable transaction rules.

The IRS may also be able to adjust its procedures to minimize the risk of a successful APA challenge in the future. For example, Professor Daniel Hemel argues that Treasury should publish reportable transaction designations as proposed rules and then finalize these rules after a sixty-day comment period, with temporary or interim final rules applying during the notice-and-comment period.[80] Professor Hemel observes that adopting these procedures would be "cumbersome" but argues that they may be "better than having the whole reportable-transaction designation regime come crumbling down."[81]

In all events, the *CIC Services* holding exposes the IRS to additional legal risk and procedural constraints, which may further impair its efforts to respond to evolving tax shelters quickly and effectively. This challenge in turn arises from the government's reliance on activity-based rules implemented by the IRS as the primary strategy for addressing abusive tax planning.

II. AN ACTOR-BASED APPROACH TO ABUSIVE TAX PLANNING

As the Supreme Court's decision in *CIC Services* has rejuvenated scholars' and practitioners' interest in the reportable transaction regime, it has also provided an opportunity to reconsider the government's primary reliance on an activity-based approach to abusive tax planning. In this Part, we argue that the government should, as a complement to current law, adopt actor-based adjustments to the tax compliance rules to detect and deter the abusive tax planning that the current activity-based rules do not reach. This model grows out of our prior work introducing a system of "progressive tax procedure," a means-based approach to the tax compliance rules and

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78. *See* Sheppard, *supra* note 15, at 1353–55 (arguing that Congress has endorsed current IRS procedures for issuing notices, as provided in § 559 of the Administrative Procedure Act and citing *Mann Construction Inc. v. United States*, No. 1:20-cv-11307, 2021 WL 1923412 (E.D. Mich. May 13, 2021)). For further discussion see also Clinton G. Wallace & Jeffrey M. Blaylock, *Administering Taxes Democratically*, 94 TEMPLE L. REV. (forthcoming 2022).

79. *See* Sheppard, *supra* note 15, at 1355 (quoting Professor Kristin Hickman as expressing skepticism of the congressional endorsement argument). As described above, the District Court in the Eastern District of Tennessee reached a similar conclusion in granting CIC Services's motion for a preliminary injunction enjoining the IRS from enforcing IRS Notice 2016-66 against CIC. *CIC Servs., LLC*, 2021 WL 4481008, at *5.

80. Hemel, *supra* note 16.

81. *Id.*

procedures.[82] Under our proposed system, the tax compliance rules would be adjusted based upon the characteristics of the actors rather than solely upon whether they engaged in certain specific activities,[83] such as listed transactions or transactions of interest.[84] These adjustments could be linked to a number of different characteristics, such as income or wealth, or a combination thereof.[85] An actor-based approach to tax compliance offers significant advantages over the primary use of rules that target specific activities.[86] At the same time, our proposed approach would complement existing activity-based rules while avoiding the limitations of the current approach.

This Part introduces the concept of an actor-based approach to address abusive tax shelters, argues that it can be more effective than reliance on activity-based rules, and shows how this approach can also be more capable of withstanding administrative law challenges after *CIC Services*.

A. An Actor-Based Approach

The current tax compliance and procedure rules, including those that address reportable transactions, typically do not account for the fact that high-income and wealthy taxpayers often benefit from advantages in their dealings with the IRS that are not available to other taxpayers.[87] For example, all taxpayers face the same civil tax penalty rates on underreporting and underpayments, they can raise the same defenses against penalties, and they benefit from the same statutes of limitations for IRS assessments.[88] The activities of wealthy and high-income taxpayers, however, account for a significant portion of the overall tax gap. For example, one recent study estimated that the top 1% of taxpayers alone account for 30% of all unreported income and 36% of all unpaid taxes, amounting to $175 billion annually in lost tax revenue.[89]

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82. *See generally* Blank & Glogower, *supra* note 10.

83. *See id.* at 318–36 (discussing the benefits of an actor-based system as compared to an activity-based system).

84. *See, e.g.*, CIC Servs., LLP v. IRS, 141 S. Ct. 1582, 1586–88 (2021) (micro-captive transactions).

85. Blank & Glogower, *supra* note 10 at 716.

86. *See* discussion *infra* Section II.B.

87. *See* discussion *infra* Section II.B.

88. *See*, *e.g.*, the generally applicable rules in I.R.C. § 6662 (accuracy-related penalties on underpayments); § 6664(c)–(d) (reasonable cause exceptions); § 6501 (limitations on assessment and collection).

89. John Guyton, Patrick Langetieg, Daniel Reck, Max Risch & Gabriel Zucman, *Tax Evasion at the Top of the Income Distribution: Theory and Evidence* 4 (Nat'l Bureau of Econ. Rsch., Working Paper No. 28542, 2021).

Under an actor-based approach to abusive tax planning, these tax compliance and procedure rules would be means-adjusted according to the wealth or income of the taxpayer.[90] As we have proposed in prior work, under this approach, high-income or wealthy taxpayers could be subject to increased tax penalty rates, longer periods of assessment, narrower tax penalty defense, and expanded information reporting obligations.[91] By supplementing the reportable transaction rules with actor-based adjustments to general tax compliance and procedure rules, the IRS could more effectively investigate tax avoidance strategies that high-end taxpayers pursue. Many of these strategies likely fall outside of the definitions of specific reportable transactions.

Some actor-based adjustments appear in the tax law today, though often in an inconsistent and haphazard manner, rather than through a coordinated and principled framework. The Code incorporates a statutory net-wealth test that applies to a range of procedural provisions, such as those addressing the burden of proof in U.S. Tax Court cases and the award of attorneys' fees in situations involving disclosure of taxpayer information.[92] These provisions are generally designed to prevent high-net-wealth taxpayers from taking advantage of rules that shift obligations or fees to the government. At the same time, other current tax compliance rules in the Code impose greater proportional burdens on lower-income taxpayers.[93] For one example, low-income individuals who claim the Earned Income Tax Credit fraudulently and, consequently, lose the ability to claim the credit again for the next ten years, can face much higher effective penalty rates than other taxpayers.[94]

90. *See supra* notes 82–85 and accompanying text.

91. Blank & Glogower, *supra* note 10, at 719–35.

92. *See* I.R.C. § 7430(c)(4)(A)(ii) (fee shifting in tax disputes); *id.* § 6404(e)(1) (review of IRS failure to abate interest charge); *id.* § 7431(c)(3) (award of attorney's fees following unauthorized inspection or disclosure of taxpayer information); *id.* § 7491(a)(2)(C) (shifting of burden of proof); *id.* § 6656(c)(1) (waiver of penalty for failure to deposit employment taxes). These rules all key to the $2 million net asset test in 28 U.S.C. § 2412(d).

93. *See* Blank & Glogower, *supra* note 10, at 698–99.

94. I.R.C. § 32(k)(1)(B)(i). In this case, the taxpayer can bear an effective penalty equal to many multiples of the underlying underpayment. A taxpayer who makes an earned income tax credit (EITC) claim recklessly or in disregard of rules or regulations can lose the credit for the next two years, which can result in an effective penalty rate of 200% of the underlying underpayment. I.R.C. § 32(k)(1)(B)(ii). In contrast to these potentially high penalty rates which would only affect lower-income taxpayers who would otherwise qualify for the EITC, the general penalty rate for fraud cases applicable to all taxpayers is 75%. I.R.C. § 6663(a).

B. General Advantages of an Actor-Based Approach

A system of actor-based responses to address tax avoidance and abuse can address the limitations of the current activity-based rules, such as the reportable transaction requirements. Most importantly, actor-based adjustments to the tax compliance rules can be implemented preemptively, rather than in reaction to taxpayers engaging in particular forms of abusive tax structuring.[95]

Actor-based adjustments can avoid the problems that the reportable transaction rules and other activity-based rules encounter when defining the scope of the targeted activities either too broadly or too narrowly. When activity-based rules are under-inclusive, they fail to target other abusive activities which enable noncompliance.[96] On the other hand, when they are over-inclusive, they can impose unnecessary burdens on lower-income or fully compliant taxpayers caught up in these rules.[97]

Actor-based adjustments can avoid these problems by only adjusting the tax compliance rules for those high-income taxpayers who enjoy particular advantages and tax avoidance opportunities under the current rules. These adjustments can tailor tax compliance rules to the unique challenges and social costs of high-end noncompliance and thereby account for the procedural advantages currently enjoyed by higher-income taxpayers. First, these adjustments can address the taxpayers who account for the proportionally highest rates of revenue lost to noncompliance.[98] High-income taxpayers also benefit from many documented advantages under the current system—where noncompliance can be hard for the IRS to detect before the statute of limitations have expired—including greater access to sophisticated tax advice and more opportunities to engage in complex structuring.[99] Finally, actor-

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95. That is, these adjustments could apply generally to all covered taxpayers, rather than specifically to certain activities.

96. *See* Chirelstein & Zelenak *supra* note 47 and accompanying text.

97. For example, Professor Shu-Yi Oei describes how the IRS's Offshore Voluntary Disclosure Program, designed to promote disclosure of taxpayer's offshore assets, often resulted in less wealthy taxpayers subject to these rules paying the highest proportional penalties, while wealthier taxpayers were often more able to avoid similar penalty rates. Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 EMORY L.J. 655, 706–08 (2018). One study found that small account holders bore average penalty rates which were almost double those of larger account holders. *Id.* at 703 (citing NAT'L TAXPAYER ADVOCATE, 1 ANNUAL REPORT TO CONGRESS 86 (2014)).

98. *See* Guyton, Langetieg, Rech, Risch & Zucman, *supra* note 89 and accompanying text.

99. These advantages include the opportunities to engage in more complex structuring, including through offshore holdings, alternative asset classes, and multiple entity tiers, which can take longer for the IRS to uncover within the specified statute of limitations periods. *See* Letter from Charles P. Rettig, I.R.S. Comm'r, to Sen. Ron Wyden (D-OR) 2 (Sept. 6, 2019),

based adjustments can address the unique costs of high-end noncompliance in a progressive tax system, where every dollar of revenue lost to noncompliance by a high-income taxpayer represents a greater social cost than a dollar of lost revenue resulting from noncompliance by a lower-income taxpayer.[100]

Of course, the majority of high-income taxpayers comply with their taxpaying obligations.[101] Actor-based adjustments can also be designed to avoid unduly burdening these compliant taxpayers. First, a low-underpayment exception can limit the application of many of these adjustments to cases of significant noncompliance, while avoiding imposing heightened compliance rules for taxpayers who are compliant or who engage in minor violations of the tax rules. Furthermore, the scope of the actor-based adjustments can be limited to ensure that high-income taxpayers still receive the same procedural rights and protections that are core prerequisites of procedural justice.[102]

Introducing a system of actor-based adjustments should also not be viewed as a radical departure from current law. Although the current tax compliance rules primarily rely on activity-based responses, the tax law already includes instances of actor-based adjustments.[103] These instances of actor-based adjustments in the current law, however, are applied inconsistently, and in some cases, impose greater burdens on lower-income taxpayers.[104]

Like activity-based rules, actor-based adjustments should not be viewed as an independent solution to the challenges of tax noncompliance. A system that relied exclusively on actor-based rules would likely be just as problematic as one relying exclusively on activity-based rules. Rather, actor-based adjustments can complement the current system of activity-based rules and redress its limitations as part of a coordinated and comprehensive legal response to promote tax compliance.

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https://www.documentcloud.org/documents/6430680-Document-2019-9-6-Treasury-Letter-to-Wyden-RE.html (describing why the most complex tax returns are often those filed by higher income taxpayers); *see also* Blank & Glogower, *supra* note 10, at 678–81.

100. That is, in a progressive tax system, a dollar of tax revenue paid by a high-income taxpayer implicitly represents a lower social cost than a commensurate dollar of income paid by a lower-income taxpayer. *See* MICHAEL J. GRAETZ, DEBORAH H. SCHENK & ANNE L. ALSTOTT, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 32–34 (8th ed. 2018) (describing the basic rationale for progressive taxation). For the same reason, a dollar of tax revenue lost from noncompliance by a high-income taxpayer represents a greater social cost than a similar dollar of tax revenue lost from noncompliance by a lower income taxpayer.

101. *See* Andrew Johns & Joel Slemrod, *The Distribution of Income Tax Noncompliance*, 63 NAT'L TAX J. 397 (2010).

102. For example, every taxpayer should be ensured the same right to appeal IRS or judicial decisions, and the same procedural protections in case of criminal, rather than civil, sanctions. *See* Blank & Glogower, *supra* note 10, at 710–11.

103. *Supra* Section II.A.

104. *Supra* notes 91–93 and accompanying text.

C. Application: Beyond Reportable Transactions

The following discussion illustrates how the government could incorporate an actor-based approach to tax enforcement to help detect and deter abusive tax planning and redress limitations in the current reportable transaction rules.

1. Penalties

The tax law contains separate civil tax penalties for taxpayers who engage in certain reportable transactions. For example, taxpayers must pay a 20% accuracy-related tax penalty for any "reportable transaction understatement," which increases to 30% in the event that the taxpayer fails to adequately disclose the transaction to the IRS.[105] Taxpayers who fail to file required disclosure statements regarding listed transactions and other reportable transactions are also subject to flat dollar tax penalties.[106] While these tax penalties can be significant, they are only applicable if the taxpayer's transaction fits into the definition of "reportable transaction."[107] In the case of other tax avoidance strategies that do not meet the definition of reportable transactions, such as abusive strategies involving the low valuation of assets and tax-deferred retirement accounts, these increased tax penalties do not apply.[108]

Taxpayers who engage in tax planning strategies other than specified reportable transactions may still be subject to more general tax penalties, such as accuracy-related tax penalties for underpayments attributable to negligence or disregard of rules and regulations.[109] Under current law, these tax penalties apply at the same rate to everyone, even though wealthy taxpayers may be able to engage in transactions that are harder to detect, and, as discussed below, they can more readily defend against these penalties by showing reliance on written opinions from tax counsel.[110]

Under an actor-based approach, Congress could adjust these general tax penalties depending upon a taxpayers' income or wealth, to equalize their impact for taxpayers in different economic circumstances. For example,

105. I.R.C. § 6662A(a), (c).

106. I.R.C. § 6707A(b).

107. *See supra* note 1 (explaining what constitutes a reportable transaction).

108. *See, e.g.*, Jesse Eisinger, Jeff Ernsthausen & Paul Kiel, *The Secret IRS Files: Trove of Never-Before-Seen Records Reveal How the Wealthiest Avoid Income Tax*, PROPUBLICA (June 8, 2021), https://www.propublica.org/article/the-secret-irs-files-trove-of-never-before-seen-records-reveal-how-the-wealthiest-avoid-income-tax.; David Kamin, David Gamage, Ari Glogower, Rebecca Kysar, Darien Shanske, Reuven Avi-Yonah et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1451–52 (2019); Cory J. Stigile, *Now I Am a C Corp: What About the Accumulated Earnings Tax?*, 163 TAX NOTES 421 (2019).

109. I.R.C. § 6662(b).

110. *See infra* note 114 and accompanying text.

instead of the 20% accuracy-related tax penalty for tax underpayments that are attributable to the taxpayer's negligence under current law,[111] Congress could revise this statute to provide that, for taxpayers with taxable income of $2 million or more, these penalties would apply at a rate of 30%. Similarly, Congress could also increase flat dollar tax penalties according to the taxpayers' income or wealth.[112] By introducing means-adjusted accuracy-related tax penalties in coordination with the special tax penalties that apply to reportable transactions, Congress could thereby empower the IRS to also deter abusive tax planning that the agency has not identified yet as a listed transaction or transaction of interest.

2. *Tax Opinions*

In many cases, high-end taxpayers can avoid the application of civil tax penalties by using a written tax opinion from a tax advisor to establish "reasonable cause and good faith."[113] The reasonable cause defense often plays a key role in tax planning by high-end taxpayers, who can purchase written tax opinions as "insurance" against tax penalties.[114] Taxpayers may rely on written opinions from tax advisors to defend against the accuracy-related tax penalties for acts such as negligence, the disregard of rules or regulations, and substantial understatements.[115] Taxpayers who engage in reportable transactions face additional requirements and limitations and cannot rely on tax opinions where the advisor has a fee arrangement that is contingent on all or part of the intended tax benefits from the transaction being sustained.[116] Taxpayers and advisors can generally circumvent these opinion reliance limitations by avoiding the specific elements of "disqualified opinions" under Section 6664(d) and related regulations and by avoiding participating in reportable transactions.[117]

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111. *Id.*

112. For instance, Congress could increase the tax penalty for failing to file a reportable transaction form from $10,000 to $50,000 in the case of taxpayers with taxable income of $2 million or more. I.R.C. § 6707A(b)(2)(B).

113. *See* IRC § 6664(c) (the reasonable cause exception); Treas. Reg. § 1.6664-4(c) (allowing for good faith reliance on advice from a professional tax advisor).

114. *See, e.g.*, Joseph Bankman, *The New Market in Corporate Tax Shelters*, 83 TAX NOTES 1775 (1999); Michael Doran, *Tax Penalties and Tax Compliance*, 46 HARV. J. LEGIS. 111, 118 (2009); Rachelle Y. Holmes, *The Tax Lawyer as Gatekeeper*, 49 U. LOUISVILLE L. REV. 185, 204–05 (2010); Leigh Osofsky, *The Case Against Strategic Tax Law Uncertainty*, 64 TAX L. REV. 489, 510–11 (2011); Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 YALE J. ON REGUL. 77, 86–88, 93 (2006).

115. Treas. Reg. § 1.6664–4(c) (describing good faith reliance on advice from a professional tax advisor).

116. I.R.C. § 6664(d)(4)(B).

117. I.R.C. § 6664(d)(4)(B)(ii)–(iii).

Under an actor-based approach, the government could revise the available tax penalty defenses by preventing high-end taxpayers from asserting the reasonable cause defense against any accuracy-related tax penalties. For instance, Treasury could provide that the reasonable cause and good faith defense would not be available to individual taxpayers with taxable income of $2 million or more.[118] The primary effect of this adjustment would be to prevent high-end taxpayers from avoiding tax penalties by showing reliance on opinion or advice, such as the written opinion of a tax lawyer or accountant. However, this change would not result in a "strict liability" penalty rule for high-end taxpayers. They could still defend against tax penalties using other available defenses, such as the "substantial authority" defense, by arguing that the weight of authorities supporting the tax treatment are substantial compared to contrary authorities.[119]

3. *Restrictions on Assessment*

Restrictions on assessment also limit the IRS's ability to deter high-end taxpayers from pursuing abusive tax planning.[120] By default, the statute of limitations runs for three years from the date that a taxpayer files a tax return.[121] Once the statute of limitations clock runs out, the IRS cannot restart it and assess additional tax liability.[122] In this context as well current law adopts an activity-based approach. If a taxpayer fails to disclose participation in a listed transaction to the IRS, the statute of limitations does not expire until one year after the taxpayer (or the taxpayer's material advisor) discloses participation in the transaction to the IRS.[123] If, however, the default statute of limitations for a taxpayer has already expired by the time the IRS designates a tax strategy that the taxpayer has used as a listed transaction, the limitations period is not reopened or extended.[124] As this special extension embodies an activity-based approach, taxpayers must also engage in a listed transaction for the rule to apply.

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118. *See* Blank & Glogower, *supra* note 10, at 726.

119. I.R.C. § 6662(d)(2)(B)(i).

120. *See, e.g.*, David Barstow, Susanne Craig & Russ Buettner, *Trump Engaged in Suspect Tax Schemes as He Reaped Riches from His Father*, N.Y. TIMES (Oct. 2, 2018), https://www.nytimes.com/interactive/2018/10/02/us/politics/donald-trump-tax-schemes-fred-trump.html (noting the unlikelihood of prosecuting tax evasion occurring outside of the statute of limitations).

121. I.R.C. § 6501(a).

122. *Id.*

123. I.R.C. § 6501(c)(10).

124. Rev. Proc. 2005-26, 2005-1 C.B. 965; Treas. Reg. § 301.6501(c)–1(g)(2) (providing that the rule extending the period until a year after disclosure "does not apply to any period of limitations on assessment that expired before the date on which the failure to disclose the listed transaction under Section 6011 occurred.").

High-end taxpayers can benefit the most from the current default statute of limitations period, since they have more opportunities to engage in complex transactions or structuring which can hide non-compliance from the IRS for a longer period of time.[125] Instead of the activity-based approach of current law, Congress could extend the default statute of limitations based on the taxpayer's income or wealth. For example, in the case of any individual taxpayer with taxable income of $2 million or more, policymakers could increase the default statute of limitations period from three years to six years, regardless of whether the taxpayer participated in a specified reportable transaction or not. An actor-based approach to the statute of limitations would enhance deterrence of high-end abusive tax planning and tax evasion and would counter taxpayer strategies to avoid assessments by taking advantage of shorter statutes of limitation periods.

4. *Information Reporting*

Information reporting requirements for specific activities, such as listed transactions and transactions of interest, play a critical role in the government's approach to abusive tax planning.[126] When effective, this system enables IRS agents to determine whether particular items in a taxpayer's return merit increased scrutiny.[127] A weakness of this activity-based approach, however, is that high-end taxpayers who have access to sophisticated tax advisors may engage in transactions that fall outside of this set of reporting requirements or may not adequately disclose information on transactions that the IRS has identified.[128]

To supplement the IRS's activity-based approach to abusive tax planning disclosure, policymakers should also consider broader, actor-based information-reporting requirements that would expand the IRS's ability to identify high-end tax noncompliance. For example, employees who earn wages are subject to information reporting and tax withholding by their

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125. *See, e.g.*, Paul Kiel & Jesse Eisinger, *How the IRS Was Gutted*, PROPUBLICA (Dec. 11, 2018), https://www.propublica.org/article/how-the-irs-was-gutted; *see also Statute of Limitations: When Taxpayers Can Tell the IRS, "You Snooze, You Lose.,"* BARNES LAW, LLP (May 7, 2016), https://www.barneslawllp.com/blog/statute-limitations-taxpayers-can-tell-irs-snooze-lose.

126. *See* Brown et al., *supra* note 22.

127. *See, e.g.*, Pearlman, *supra* note 44 at 294–98 (describing audit efficiency as one of the prime rationales for enhanced tax shelter disclosure); Sheryl Stratton, *Inside OTSA: A Bird's-Eye View of Shelter Central at the IRS*, 100 TAX NOTES 1246, 1246–47 (2003) (discussing role of reportable transaction disclosure statements in the IRS's tax shelter detection efforts).

128. *See* Blank, *supra* note 12, at 1642–53; John S. Dzienkowski & Robert J. Peroni, *The Decline in Tax Adviser Professionalism in American Society*, 84 FORDHAM. L. REV. 2721, 2729–38 (2016).

employers.[129] Where substantial third-party information reporting applies, individual tax compliance is approximately 95%.[130] Many high-end taxpayers, in contrast, earn their income from businesses they own and investments that are subject to little, if any, third-party information reporting.[131] To address this disparity, policymakers should introduce additional third-party and taxpayer information reporting rules for high-end taxpayers. These rules could include requiring third parties, including banks and other financial institutions, to report the gross inflows to and outflows from high-end taxpayers' accounts,[132] and requiring individual high-end taxpayers to submit an annual wealth reporting form with their annual tax returns. The goal of any such increased disclosure should be to allow the IRS to observe information relevant to the tax compliance of high-end taxpayers, whether related to the currently designated reportable transactions or not.

5. *An Exception for Small Underpayments*

If policymakers introduce the means-adjusted tax compliance rules described above, high-end taxpayers could face adjustments—such as higher penalties for small tax underpayments or minor offenses—simply because they meet the overall income or wealth requirement. To address this concern, policymakers should create an exception to many of these adjustments for low-value amounts of understatements of income or underpayments of income tax. For instance, many tax penalty provisions

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129. I.R.C. § 6041(a) ("All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages . . . of $600 or more in any taxable year shall render a true and accurate return to the Secretary . . . ").

130. IRS, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013, at 14 (2019), https://www.irs.gov/pub/irs-pdf/p1415.pdf (describing 95% compliance where income is "subject to substantial information reporting"); Leandra Lederman & Joseph C. Dugan, *Information Matters in Tax Enforcement*, 2020 BYU L. REV. 145, 147 (describing voluntary compliance rates); Joel Slemrod, Brett Collins, Jeffrey L. Hoopes, Daniel Beck & Michael Sebastiani, *Does Credit-Card Information Reporting Improve Small-Business Tax Compliance?*, 149 J. PUB. ECON. 1 (2017).

131. *See* Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM. L. REV. 1733, 1742–52 (2010). High-income and wealthy taxpayers, however, are subject to third-party information reporting of their basis in securities. *See* I.R.C. § 6041(g); Treas. Reg. § 1.6045–1(c).

132. *See, e.g.,* U.S. DEP'T OF THE TREASURY, THE AMERICAN FAMILIES PLAN TAX COMPLIANCE AGENDA 18 (May 2021) (describing Biden Administration proposals to increase information reporting). Under this proposal, financial institutions would "report gross inflows and outflows on all business and personal accounts from financial institutions, including bank, loan, and investment accounts but carve out exceptions for accounts below a low de minimis gross flow threshold." *Id.*

calculate the amount of the penalty by applying a rate to the taxpayer's underpayment of income tax.[133] Policymakers could include an exception from means-adjusted tax penalties where the amount of a taxpayer's underpayments for the year fall below a specific dollar value, such as $50,000. This type of exception would protect taxpayers who commit minor tax offenses from incurring unduly burdensome adjustments that are designed to address significant acts of noncompliance by high-end taxpayers.

An actor-based approach to abusive tax planning would complement, rather than replace, the current activity-based reportable transaction rules. While the reportable transaction disclosure rules have limitations, they can help the IRS to detect when taxpayers use known abusive tax strategies and to deter them from using those strategies in the future. To address the gaps in the current reportable transaction regime, policymakers should also create a broader tax-enforcement net by tailoring the tax compliance rules to the individual characteristics of the taxpayer.

D. Advantages of an Actor-based Approach After CIC Services

After *CIC Services*, the government's activity-based approach to detecting abusive tax shelters faces additional legal obstacles and risks which can prevent the IRS from effectively implementing the reportable transaction rules. The risk of litigation or preemptive challenges can slow the IRS's ability to collect information from taxpayers and advisors about emerging tax shelter transactions, and parties with vested interests may seek injunctions against IRS actions.[134] After *CIC Services* the IRS will also face greater legal uncertainty regarding the outcomes of these challenges. At the same time, if the IRS changes its procedures to reduce legal exposure, it risks taking additional measures beyond what the APA requires, which can further impair its efforts to challenge emerging tax shelter transactions. The IRS may also hesitate to issue new listed transaction and transaction of interest notices if these additional obstacles would make notices more burdensome and less effective.[135]

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133. *See* I.R.C. § 6662.

134. For discussion, see James M. Puckett, *Structural Tax Exceptionalism*, 49 GA. L. REV. 1067, 1109–18 (2015). For discussion of value of pre-enforcement litigation to taxpayers, see Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 VA. L. REV. 1683, 1765 (2017); Stephanie Hunter McMahon, *Pre-Enforcement Litigation Needed for Taxing Procedures*, 92 WASH. L. REV. 1317, 1362–91 (2017).

135. For example, following Congress's enactment of significant penalties for noncompliance with the reportable transaction rules, the IRS appears to have designated fewer tax strategies as listed transactions. *See* Hemel, *supra* note 16 (observing that the IRS has only designated two transactions as listed transactions since 2015).

Actor-based adjustments could avoid many of these limitations. First, an actor-based approach can be implemented generally and preemptively across multiple areas of the tax compliance rules, through legislative changes enacted, or in some applications through rulemaking by Treasury. In contrast, activity-based rules are often implemented on a transaction-by-transaction basis, through agency rulemaking, and often under time constraints.[136] Because actor-based rules can be applied generally and preemptively, even Treasury can implement certain adjustments with less legal risk and with time for notice-and-comment when required by the APA.[137]

Second, actor-based adjustments can help improve the function of the current tax shelter rules implemented by the IRS. If the default statute of limitations for a taxpayer has already expired by the time the IRS designates a tax strategy as a listed transaction or a transaction of interest, the limitations period is not reopened or extended.[138] In this case, the issuance of the notice would have no effect in improving compliance. However, an actor-based adjustment extending the statute of limitations period for high-end taxpayers would allow notices of a listed transaction or a transaction of interest to remain in effect for a longer period and could reduce the pressure the IRS faces to issue notices quickly.

Third, actor-based adjustments can reduce taxpayer incentives to complete tax shelter transactions quickly, before they are detected by the IRS. When the government targets specific abusive tax strategies through statute or regulation, taxpayers may attempt to argue that their use of the strategies prior to enactment of these activity-based rules was permissible. For example, in *Compaq Computer v. Commissioner*,[139] the taxpayer, Compaq, purchased $900 million of Royal Dutch American Depository Receipt (ADR) shares, received a dividend, claimed a foreign tax credit in the United States, and then quickly sold the ADRs.[140] The Fifth Circuit held that Compaq's tax-shelter strategy should have been allowed because Compaq completed all of its transactions before Congress enacted the activity-based rule that would have prohibited the practice.[141] Actor-based adjustments, on

136. *See* U.S. DEP'T OF THE TREASURY, POLICY STATEMENT ON THE TAX REGULATORY PROCESS 2–3 (Mar. 5, 2019).

137. *See Id.* (describing the Treasury Department's commitment to public participation and transparency in tax regulatory process).

138. *See supra* Subsection II.C.3.

139. 277 F.3d 778 (5th Cir. 2001).

140. *Id.*

141. *Id.* For criticism of this decision, *see* Daniel N. Shaviro & David A. Weisbach, *The Fifth Circuit Gets It Wrong in* Compaq v. Commissioner, 94 TAX NOTES 511, 514 (2002); David P. Hariton, *The* Compaq Case*, Notice 98–5, and Tax Shelters: The Theory Is All Wrong*, 94 TAX NOTES 501 (2002); Shannon Weeks McCormack, *Tax Shelters and Statutory Interpretation: A Much Needed Purposive Approach*, 2009 U. ILL. L. REV. 697 (2009).

the other hand, would not incentivize taxpayers to rush to use specific tax avoidance strategies before the government acts to shut them down or to make similar arguments in tax controversy disputes with the IRS.

Finally, actor-based adjustments face less risk of opposition by special interest groups that hold disproportionate stakes in responses to specific activity-based rules. Since activity-based tax shelter rules are, by necessity, often implemented on a transaction-by-transaction basis, certain tax advisors and promotors who specialize in particular transactions may have a greater incentive to challenge agency actions targeting those transactions.

Scholars have documented the risk of special interests obstructing agency rulemaking, when these interests have a disproportionate stake in the outcome and the narrow issue is less salient to the general public.[142] *CIC Services* offers an example of this effect. The petitioner, CIC Services, specialized in advising taxpayers on the specific captive insurance transactions targeted by the IRS. The petitioner thereby had a disproportionate interest in challenging the IRS's efforts to stop this specific abusive tax transaction.[143]

An actor-based approach, in contrast, does not encounter this type of special interest problem, even when specific adjustments are implemented through administrative rather than through legislative action. Since actor-based adjustments are applied generally, without targeting specific transactions or industries, they avoid a potential disparity in the salience of these rules among the general public and affected parties.

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142. For example, Professor Clinton Wallace describes the "lopsided" nature of the "notice-and-comment" process in tax rulemaking, where in many cases private special interest groups have accounted for a disproportionate share of all comments on regulatory action during the period studied. Clinton G. Wallace, *Congressional Control of Tax Rulemaking*, 71 TAX L. REV. 179, 216–30 (2017). Wallace attributes this phenomenon to a number of factors which are more pronounced in the context of tax rulemaking, including the low salience of narrow and technical issues, and the potential for "concentrated costs" on particular actors but "diffuse benefits" to the public. *Id.* at 220. Wallace notes that scholars have identified similar dynamics in the contexts of rulemaking by other agencies. *Id.* at 220 (citing Wendy Wagner, Katherine Barnes & Lisa Peters, *Rulemaking in the Shade: An Empirical Study of EPA's Air Toxic Emission Standards*, 63 ADMIN. L. REV. 99 (2011); Jason Webb Yackee & Susan Webb Yackee, *A Bias Towards Business? Assessing Interest Group Influence on the U.S. Bureaucracy*, 68 J. POL. 128 (2006)). Wallace argues however that many tax rules are unique in that they are purely "zero-sum," in that "[a] failure to raise revenue currently implies a tax increase on future taxpayers" who "are particularly poorly positioned to have organized groups representing their interests." *Id.* at 222; *see also* Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PENN. L. REV. 1 (1990).

143. *See* CIC Servs., LLC v. IRS, 141 S. Ct. 1582, 1588 (2021) ("The petitioner is CIC Services, a material advisor to taxpayers participating in microcaptive transactions.").

CONCLUSION

The Supreme Court's decision in *CIC Services* offers scholars and practitioners a fresh opportunity to reexamine the government's approach to detecting and deterring abusive tax shelters. In light of this occasion, this Article has made several contributions to the discussion among tax practitioners and scholars of the reportable transaction regime.

The Article has first presented the specific advantages of an actor-based model of tax enforcement in the context of tax shelter reporting rules, which would adjust the tax compliance rules based on the economic circumstances of the taxpayer, rather than solely as a result of specific abusive tax activities. As we have argued, this model would enhance the IRS's power to enforce the tax law against high-income and wealthy taxpayers. It would complement, rather than replace, the reportable transaction rules.

In addition to presenting the general limitations of the government's current activity-based approach to abusive tax planning, this Article has highlighted an additional weakness. After *CIC Services*, the IRS is likely to face litigation hurdles in the form of preemptive challenges under the APA. Putting the legal merits of the arguments aside, these challenges are often at odds with exigencies of the IRS's tax shelter notices. This Article has explained how these challenges result from the government's primary reliance on an activity-based approach.

Finally, the Article describes how an actor-based approach can be coordinated with the current reportable transaction disclosure requirements to provide a more comprehensive and effective approach to combating abusive tax planning.