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TAX BENEFITS IN MITIGATION OF RULE 10b-5 DAMAGES: WILLIAM Z. SALCER v. ENVICON EQUITIES CORP.

I. INTRODUCTION

Securities investors who claim to have been induced by fraud or deceptive disclosure in the course of investing may file private litigation actions under rule 10b-51 pursuant to section 10(b) of the Securities Exchange Act of 1934.2 The damages awardable in such actions, however, are limited to “actual damages.”3 The application of the “actual damages” limitation to securities that have been packaged and sold in the form of tax shelters has provided defendants in rule 10b-5 actions with the following unique affirmative defense:

[D]efendants in private damage actions stemming from tax shelter investments may seek to establish that irrespective of any alleged mis-statements, omissions or fraudulent conduct, plaintiffs suffered little or no “actual” damages because of the tangible economic benefit they derived from their investments in the form of large tax deductions which may be used to offset their sizable outside incomes.4

In response to this “tangible economic benefit” defense, and in a case of first impression, the Second Circuit Court in William Z. Salcer v. Envicon Equities Corp.5 (Salcer) held that tax benefits received from tax shelter investments should be considered when determining the amount of damages based on a violation of rule 10b-5 of the Securities Exchange Act of 1934.

1. 17 C.F.R. § 240.10b-5 (1985). Rule 10b-5 states:
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
   (a) To employ any device, scheme, or artifice to defraud,
   (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
   (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

3. Id. § 78bb(a); see also infra notes 69-108 and accompanying text.
4. Russo, Rule 10b-5 Litigation and Tax Shelter Investments, 10 SEC. REG. L.J. 339, 340 (1983). This article also discusses the effect of the consideration of tax benefits on the discovery stage of the litigation process.
Act of 1934. This Note will examine the ramifications of the Salcer decision in light of the unique interrelationship of tax benefits generated by tax shelter investments and the damages award issue.

II. TAX SHELTERS: BACKGROUND INFORMATION

The Securities and Exchange Commission's (SEC's) role regarding tax shelters arises primarily from the sections of the securities laws related to registration and antifraud. First, however, tax shelter investment interests must be treated as securities; then, they are subject to SEC regulation. This is accomplished by classifying tax shelter investments as "investment contracts." Although the term "investment contract" is not defined in the Securities Act of 1933 or the Securities Exchange Act of 1934, the Supreme Court in SEC v. W.J. Howey Co. held that an investment contract exists where there is (1) a contract, transaction, or scheme; (2) in which a person invests money; (3) in a common enterprise; (4) with the expectation that she or he would earn a profit solely from the efforts of others. The fourth element of the Howey test is satisfied as long as there exists some expectation of profit, even though the main or sole reason why an investor invests in the venture is the expectation of substantial tax benefits.

6. See id. at 941. In fact, the court went on to state that tax benefits "resulting directly from a transaction under attack must be credited toward the damage award." Id. at 942.

As used in this Note, the term "tax benefits" refers to the tax savings generated by tax deductions associated with an investment. For example, a tax deduction of $100 by an investor in the 50% tax bracket yields a tax benefit of $50.

7. Under section 5 of the Securities Act of 1933, it is unlawful to sell a security by means of interstate commerce or the mails until a registration statement is in effect or has been filed, unless the registration is exempt. 15 U.S.C. § 77(e) (1982). Section 10b of the Securities Exchange Act of 1934 prohibits acts or practices which would operate as a fraud in connection with the purchase or sale of a security. See id. § 78j(b). Section 17(a) of the Securities Act of 1933 deals with similar acts or practices which would operate as a fraud in the offer and sale of any security. See id. § 77q(a).

8. See id. § 78(q).


11. Id. at 298-99.


An investment which takes the form of a general partnership or joint venture is not insulated from the securities laws; but, it usually fails the "solely from the efforts of others" test because the
Tax shelter investments have continued to proliferate into the 1980's.13 This proliferation has prompted issuance of congressional legislation in an attempt to curtail the abusive tax implications of such investments.14 In response to abusive tax shelters, the SEC has also attempted to assert its injunctive authority promulgated under both the 1933 and 1934 Acts.15 SEC enforcement actions involving fraud in tax shelter investments have been filed as a result of alleged misrepresentations and omissions concerning: (1) the tax consequences of the investment;16 (2) assets acquired by the tax shelter;17 (3) the use of proceeds generated by the investment;18 (4) commingling of assets in the tax shelter;19 and

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17. E.g., SEC v. Bonastia, 614 F.2d 908, 911 (3d Cir. 1980) (General partnership interests of
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(5) conversion of investor funds to promoters’ and others’ use.

Tax shelters may take many forms and may be defined in many ways; however, they generally possess either one or both of the following attributes: (1) Deductions in excess of income from the investment, taken in order to reduce income from other sources in that year; (2) credits in excess of the tax attributable to the income from the investment, taken in order to offset taxes or income from other sources. These “write-offs” are often viewed as “artificial losses” because they are usually noneconomic in nature but nevertheless are available as deductions under existing law.

These “artificial losses” can be created, for example, in a partnership context. The Internal Revenue Code permits a partnership to serve as a conduit to the partners for all its taxable income and losses; however, each partner may take his or her share of the partnership’s deductible losses only to the extent of the adjusted basis of his or her partnership interest. The unique advantage served by a limited real estate partnership, as opposed to most of the other types of limited or general part-
nerships, is that the limited partner’s basis is not currently subject to the IRS’s “at-risk” rules.27 The limited partner’s basis therefore may be increased by his or her proportional share of any nonrecourse loans28 made to the partnership.29 Thus, the partnership is able to “artificially” generate large amounts of deductible losses and expenses in the early years of the partnership which are passed on to the partners to use in offsetting other income on their individual returns.30

The availability of these “artificial losses” plays an important role in an investor’s decision to invest in a partnership and explains the packaging of such investments as “tax shelters.”

III. PRIOR CASE LAW

The case law prior to Salcer was confusing and unsettled on the issue of reducing damages awarded in rule 10b-5 violations by tax benefits received from tax shelter investments by the injured party.31 One


28. Nonrecourse loans are defined as loans for which the personal assets of the debtor are not subject to attachment if the debtor should default on the loan. A. ROSENBERG, EVALUATING TAX SHELTER OFFERINGS 149 (1978).

29. The objective of an “at-risk” rule is to limit the allowed loss to the amount that the investor is economically “at-risk” with respect to that activity. R. TANNENHAUSER & C. TANNENHAUSER, TAX SHELTERS: A COMPLETE GUIDE 65 (1978). An investor is considered “at-risk” with respect to any money or property he or she contributed, any loans for which he or she is personally liable, and any property he or she pledges to secure such loans. Id. Nonrecourse loans—loans for which the investor is not personally liable—are not “at-risk” contributions, but the real estate limited partnerships are permitted to take advantage of the “leverage” provided by nonrecourse financing. See I.R.C. § 465(c)(3)(D) (1982 & Supp. I 1983); Crane v. Commissioner, 331 U.S. 1 (1947) (basis of property subject to a mortgage is undiminished by the mortgage’s value).

30. See Austin v. Loftsgaarden, 675 F.2d 168, 173 n.6 (8th Cir. 1982), aff’d en banc, 768 F.2d 949 (8th Cir. 1985), cert. granted sub nom. Randall v. Loftsgaarden, 54 U.S.L.W. 3328 (U.S. Nov. 12, 1985) (No. 85-519). The court offered the following example:

A hypothetical real estate partnership might show a $50,000 loss in one year. Assume that this loss was obtained by taking the difference between $60,000 of deductible depreciation and $10,000 of gross rents in excess of operating expenses and interest. If mortgage amortization, a nondeductible expense, were $2,000, then the partnership would have a positive cash flow of $8,000. If under the partnership agreement, one limited partner were entitled to 50% of the partnership losses and 37.5% of the cash flow, that partner would receive $3,000 in cash, but his tax return would reflect only his share of the partnership’s net loss, or $25,000.

Id. (quoting Note, Real Estate Limited Partnerships and Allocational Efficiency: The Incentive to Sue for Securities Fraud, 63 VA. L. REV. 669, 673 n.22 (1977)).

31. The judicial dilemma is not isolated to securities fraud cases. The courts have continued to struggle with this same issue with respect to personal injury damage awards. The Supreme Court has ruled that juries must be instructed regarding the nontaxability of personal injury damage awards filed under the Federal Employers Liability Act (FELA). See Norfolk & W. Ry. v. Liepelt, 444 U.S. 490 (1980). Many state courts, however, would still consider it reversible error to mention in argument or jury instructions income tax treatment of damage awards. See e.g., Klawonn v.
month before the Second Circuit Court’s Salcer decision, the Ninth Circuit Court held in Western Federal Corp. v. Erickson\(^{32}\) that the damages award should *not* be reduced by the amount of tax benefits received by the plaintiffs from the investment.\(^{33}\)

The *Western* case involved plaintiffs who invested in a silver mining venture.\(^{34}\) The plaintiffs were a corporation and a major shareholder of that corporation, representing two of the sixty-six investors in the venture.\(^{35}\) The plaintiffs demanded rescission of the initial agreement and a refund of their initial cash investment after discovering difficulties associated with the project.\(^{36}\) When the defendants refused to comply with the plaintiffs’ requests,\(^{37}\) the plaintiffs filed suit under rule 10b-5. Judgment was awarded for the plaintiffs, including an order for the defendants to repay the initial cash investment and prejudgment interest and attorney’s fees.\(^{38}\) On appeal, the defendants asserted the judgment should be reduced by tax benefits received by the plaintiffs.\(^{39}\) The Ninth Circuit Court quickly disposed of the issue in favor of the plaintiffs by relying upon its recent decision in Burgess v. Premier Corp.\(^{40}\)

In Burgess, the plaintiffs had purchased tax shelter investments in cattle herds, based on a representation by the defendant corporation that its cattle were of superior quality.\(^{41}\) Each plaintiff claimed extensive tax

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32. 739 F.2d 1439 (9th Cir. 1984).
33. *Id.* at 1444.
34. *Id.* at 1441. Erickson, a geologist, and Davis, an accountant, were the promoters of the venture. Erickson was to stake out and record mining claims in the Gila Canyon area of Nevada. The claims would then be assigned to investors. Erickson was to develop the mines, and then turn over the operation to defendant, Gila Mines Corporation, for which Davis was the president and principal shareholder. *Id.*
35. *Id.*
36. *Id.* The investor, Guaclices, met with Erickson to discuss the investment. During the meeting, Guaclices learned that Davis had been paid more than $400,000 for services. Guaclices demanded a return of his initial cash investment of $80,000. *Id.*
37. *Id.*
38. *Id.* Attorney’s fees of $20,000 were awarded. The court also ordered the cancellation of the promissory notes, development contracts, and mining contracts associated with the investment. *Id.*
39. *Id.* at 1444.
40. 727 F.2d 826 (9th Cir. 1984).
41. *Id.* at 830. The plaintiffs purchased their investments pursuant to registration statements and prospectuses filed with the SEC. *Id.* A prospectus explains the investment to potential investors, and its content must follow certain rules and regulations. *See* 15 U.S.C. §§ 77(b)(10), 77(q) (1982).
deductions but continued to lose money on the investment itself,\(^{42}\) which was ultimately disposed of at a substantial loss.\(^{43}\) The Ninth Circuit Court awarded damages in the amount of the investors' out-of-pocket losses but did not permit a reduction for tax benefits received.\(^{44}\) The court reasoned that the plaintiffs would be required to include in income the tax benefits previously received due to the tax benefit rule,\(^{45}\) obviating the possibility of the plaintiffs reaping a double benefit.\(^{46}\)

Several years prior to *Western* and *Burgess*, however, the United States District Court for the Southern District of Texas held in *Bridgen v. Scott*\(^{47}\) that ignoring the tax consequences of the investment would be tantamount to trying the case before a "blindfolded" court and jury residing in "an artificial 'never-never land.'"\(^{48}\) The district court also rejected the potential impact of the tax benefit rule by reasoning that even if the plaintiffs were required to include tax benefits previously received as income, the tax impact would not necessarily equate to the tax savings previously afforded the plaintiffs.\(^{49}\) The *Bridgen* court also distinguished other previous cases excluding tax benefits when awarding damages.\(^{50}\)

The Eighth Circuit Court, as reflected in its holding of *Austin v.*
Loftsgaarden,51 is also in opposition to the Ninth Circuit Court's holdings in Western and Burgess. In Austin, the plaintiffs were investors in a limited partnership organized for the purpose of building and operating a Ramada Inn motel.52 The district court had found the defendants liable for claims under rule 10b-5 and awarded the plaintiffs the amount of the consideration that each had paid for the limited partnership unit or units plus prejudgment interest and attorney's fees.53 The district court had rejected the defendants' proffer of evidence that three of the four plaintiffs suffered no actual damages due to their tax savings from the investment.54

On appeal, the Eighth Circuit Court held it was reversible error to deny admission of such evidence because "the strictly compensatory nature of damages awardable in private securities fraud actions requires that such value be taken into account in determining whether and to what extent damages were inflicted upon plaintiffs."55 The court limited its ruling specifically to investments marketed and sold as tax shelters.56

Thus, prior to Salcer, the Ninth Circuit Court, the Eighth Circuit Court, and the various district courts that had ruled on the issue of whether the remedy available to a securities investor must be reduced by any tax benefits received were split on the matter.

IV. THE SALCER DECISION

A. Summary of Facts

The facts in Salcer, as in Austin and Burgess, involved a limited partnership57 offering. In Salcer, the particular investment of the limited partnership was the formation, construction, ownership, and operation of a residential apartment complex located in Harris County, outside the

51. 675 F.2d 168 (8th Cir. 1982), aff'd en banc, 768 F.2d 949 (8th Cir. 1985), cert. granted sub nom. Randall v. Loftsgaarden, 54 U.S.L.W. 3328 (U.S. Nov. 12, 1985) (No. 85-519).
52. Id. at 172. A limited partnership was formed to help finance the $3.5 million project. One million was to be raised by selling 40 limited partnership units to not more than 20 investors for $25,000 per unit. The remainder of the money was to be obtained through mortgage and furniture and fixture loans. Id. at 173.
53. Id. at 172. The district court had applied a rescissory remedy.
54. Id. at 181.
55. Id. at 183. The court extended the application of its holding to claims brought under Minnesota securities laws. See id. at 181.
56. Id. at 183.
57. For a brief explanation of a limited partnership, see supra note 26.
Houston city limits. The plaintiffs had based their investment decision in part on sales literature which included a "Private Placement Memorandum." The memorandum contained a financial analysis projection of the capital appreciation of the apartment complex and stated, "Only persons whose income is subject to high rates of income taxation will derive the full economic benefit of the intended tax benefits of this offering."

The plaintiffs suffered a net investment loss of $47,500 per unit as a result of a forced sale. They alleged that the defendants knew or should have known and failed to disclose that Houston, Texas was planning to annex the premises on which the apartment complex was located, and that the annexation could be expected to cause a substantial increase in the costs of building and operating the complex. Since the financial analysis included in the memorandum did not reflect these increased costs, the plaintiffs sought the $47,500 per unit loss figure as rescissory damages.

The defendants' affirmative defense asserting that the plaintiffs had realized tax benefits in excess of their claimed loss of $47,500 was struck down by the district court. On appeal of this issue, the plaintiffs were joined by the Department of Justice and the SEC as amicus curiae. Even with this additional strength, however, the Second Circuit Court reversed the granting of the motion to strike the defendants' affirmative defense and remanded the case for further proceedings.

B. Analysis of the Salcer Decision

The Second Circuit Court's opinion was premised on two major points of analysis: (1) The statutory interpretation of "actual damages" as used in section 28(a) of the Securities Exchange Act of 1934, and (2) the inapplicability of the tax benefit rule to recovery of rescissory damages.

58. Salcer, 744 F.2d 935, 937 (2d Cir. 1984).
59. Id.
60. Id.
61. Id. at 938. The investors received $30,000 per unit, as proceeds from the forced sale. The investors' basis in each unit was $77,500, thus a net loss of $47,500 resulted. Id. at 937-38.
62. Id. at 937.
63. Id. at 938.
64. Id.
65. Id. at 941, 942.
66. Id. at 944.
67. Id. at 939-40.
68. Id. at 943.
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1. Interpretation of "Actual Damages"

Damages which may be recovered for fraud in violation of the Securities Exchange Act of 1934 are limited to "actual damages" pursuant to section 28(c).\(^69\) The term "actual damages" is not defined in the 1934 Act itself; thus, it has been interpreted in various ways by the courts.\(^70\) In fact, several earlier cases held that the "actual damages" limitation was not applicable to rule 10b-5 actions since they stemmed from common law tort principles, rather than from the 1934 Act.\(^71\) This issue was settled by the Supreme Court in a 1972 rule 10b-5 case, *Affiliated Ute Citizens v. United States*, when the Court made reference to section 28 in its holding.\(^72\)

The Supreme Court has equated "actual damages" with "compensatory damages" since its 1876 decision, *Birdsall v. Coolidge*,\(^73\) where it stated, "Compensatory damages and actual damages mean the same thing; that is, that the damages shall be the result of the injury alleged and proved, and that the amount awarded shall be precisely commensurate with the injury suffered . . . ."\(^74\) The definition of compensatory damages, however, is subjected to a further interpretational query—should damages be based on an "out-of-pocket" rule, a "benefit-of-the-bargain" rule, or some other appropriate standard?\(^75\)

The courts are split on this damages issue as well,\(^76\) with the tradi-

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\(^70\) A variety of measures of recovery may be sought by investors defrauded in securities transactions. See 5C A. Jacobs, Litigation and Practice Under Rule 10b-5 § 260.03(c) (rev. 2d ed. 1985).


\(^73\) 93 U.S. 64 (1876).

\(^74\) Id.

\(^75\) See generally A. Jacobs, supra note 70; Annot., 29 A.L.R. Fed. 646 (1976).

\(^76\) Confusion regarding rule 10b-5 remedies has been blamed on the courts’ failure to recognize that the rule derives from two sources at common law: (1) tort law, which focuses on the harm to the plaintiff; and (2) unjust enrichment, which focuses on the defendant’s gain. See Thompson, The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages, 37 Vand. L. Rev. 349, 352 (1984). In addition, the wide range of activities covered by rule 10b-5 attributes to the variety of damages awarded. See A. Jacobs, supra note 70, § 260.03(a).
tional measure of damages for a rule 10b-5 violation being the “out-of-pocket” theory. The measure awards the difference between the amount paid by the investor and the actual value the investor received. Consequential damages that resulted from the misrepresentation may also be recovered. Some courts have allowed “benefit-of-the-bargain” damages, which represent the difference between the value of the security as represented by the defendant and the fair market value of the security on the date of trade. The measure of damages issue is further complicated in tax shelter investment cases because of the “dual motives” of the investors who enter into the venture.

The “dual motives” involved in a tax shelter investment decision are: (1) The tax benefits to be received, and (2) the anticipated capital appreciation of the asset in which the plaintiff invested. The district court in Salcer deemed the existence of these two motives so important that it ruled the tax benefits received by the plaintiffs did not reduce the damages award because “[t]hose tax benefits would have been realized whether or not there was a fraud in this particular situation.” The district court reasoned that the allegations of fraud pertained only to the capital appreciation aspect of the investment, not to the tax benefit aspect, because the investors had not made a claim of fraud for this aspect of the investment and had received the tax benefits as outlined in the “Private Placement Memorandum.” The SEC espoused the same view as the district court.

But, on appeal, the Second Circuit Court rejected this rationale due to its interpretation of and reliance on the “actual damages” limitation contained in section 28(a) of the Securities Exchange Act of 1934, which states:

The rights and remedies provided by [the 1934 Act] shall be in

77. See A. Jacobs, supra note 70, § 260.03(a).
79. See Madigan, Inc. v. Goodman, 498 F.2d 233, 238-39 (7th Cir. 1974) (damages incurred by plaintiff while trying to avoid insolvency were allowed).
81. See Salcer, 744 F.2d at 938.
82. Id. (quoting unreported district court opinion of Salcer, southern district of New York (Broderick, J.)).
83. Id. at 937-38. The investors had received $67,866 in tax savings from their initial investment of $77,500, in addition to the $30,000 received upon sale of the investment. Thus, they were $20,366 better off prior to filing their rule 10b-5 action. Id. at 942.
84. Id. at 940 n.5, 941 (SEC joined as amicus curiae on appeal).
addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of [the 1934 Act] shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.\textsuperscript{85}

In \textit{Salcer}, although the Second Circuit Court recognized that the "actual damages" limitation does not necessarily rule out "benefit-of-the-bargain" damages, it equated actual damages to a "net economic loss" concept.\textsuperscript{86} The court saw no reason to exclude such factors in a computation for damages since tax benefits received are integral factors in any "net economic" analysis.\textsuperscript{87} The circuit court stated, "It is not within our power to ignore benefits bargained for and received by plaintiffs as a result of the transaction at issue, which represent real economic value mitigating any loss they may have suffered."\textsuperscript{88}

The Eighth Circuit Court employed a similar rationale in \textit{Austin} when it required actual damages be "reduced by any value received as a result of the fraudulent transaction."\textsuperscript{89} Even the Ninth Circuit Court in \textit{Burgess}, although holding that damages should not be reduced by tax benefits received, has recognized the relevancy of tax consequences for certain purposes in the damages issue.\textsuperscript{90} The SEC has also recognized the integral role which tax benefits play in real estate limited partnership

\textsuperscript{85} 15 U.S.C. § 78bb(a) (1982). Section 28(a) appears to rule out the possibility of recovering punitive damages. Also, recovery under both rule 10b-5 and another federal or state remedy is prohibited. The Supreme Court, however, has acknowledged that windfall damages may exist and have allowed plaintiffs to recover the benefit reaped by the defendant, even if it exceeded the plaintiff's actual loss. See, e.g., Nelson v. Serwold, 576 F.2d 1332, 1338 (9th Cir.), \textit{cert. denied}, 439 U.S. 970 (1978); Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir.), \textit{cert. denied}, 382 U.S. 879 (1965).

\textsuperscript{86} \textit{Salcer}, 744 F.2d at 940. Other courts have utilized the same theory. See, e.g., Herpich v. Wallace, 430 F.2d 792, 810 (5th Cir. 1970) (limiting damages to "economic injury"); Verrecchia v. Paine, Webber, Jackson & Curtis, 563 F. Supp. 360, 367 (D.P.R. 1982) (limiting damages to economic losses); Greitzer v. United States Nat'l Bank, 326 F. Supp. 762, 764 (S.D. Cal. 1971) (design of 1934 Act was to afford "purely economic protection").

\textsuperscript{87} See \textit{Salcer}, 744 F.2d at 940-41.

\textsuperscript{88} \textit{Id.} at 940.

\textsuperscript{89} \textit{Austin}, 675 F.2d at 181 (citing Garnatz v. Stifel, Nicolaus & Co., 559 F.2d 1357, 1361 (8th Cir. 1977), \textit{cert. denied}, 435 U.S. 951 (1978)).

\textsuperscript{90} \textit{Burgess}, 727 F.2d at 838. The court distinguished the relevancy of recognizing tax benefits in personal injury judgments versus tax shelter fraud judgments—compensatory damages awarded for personal injury are excluded from gross income. \textit{Id.} (citing In re Air Crash Disaster Near Chicago, Ill., 701 F.2d 1189 (7th Cir.), \textit{cert. denied sub nom.} Kahl v. McDonnell Douglas Corp., 464 U.S. 866 (1983)); see also supra note 31.
tax shelters; this recognition is shown by its requirement that the offeror disclose prospective tax benefits that might be realized from the investment.91

The consideration of tax benefits in damage awards, however, can be a “two-edged sword.” Tax benefits could actually increase, rather than decrease, damages. In Salcer, the court pointed out that the investors had received the tax benefits bargained for;92 but, what if tax benefits bargained for are not received?93

The treatment of tax benefits bargained for but subsequently disallowed by the Internal Revenue Service (IRS) was the issue in the recent securities fraud case before the Second Circuit Court, Freschi v. Grand Coal Venture.94 In Freschi, the plaintiff invested $266,500 of trust funds in the Grand Coal Venture largely for tax shelter purposes.95 During the term of the investment, the plaintiff realized substantial tax benefits from the investment.96

These benefits were subsequently disallowed by the IRS, resulting in repayment of $659,846.67, plus a $264,500 interest penalty, by the plaintiff to the IRS.97 The IRS did allow the plaintiff to deduct the investment cost of $266,500 as an investment loss which provided the plaintiff with state and federal tax benefits of $188,682.98 The jury at the district court level awarded the plaintiff $926,346 in damages, which appears to have

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91. See Salcer, 744 F.2d at 942.
92. Id. at 940.
93. Deductions stemming from tax shelter investments may be disallowed by the Internal Revenue Service on the grounds that the taxpayers entered into the shelter anticipating losses, not profits. Deductions for activities “not engaged in for profit” are disallowed under I.R.C. § 183 (1982). See, e.g., Brannen v. Commissioner, 78 T.C. 471 (1982) (losses for a venture that syndicated a film for $1.7 million were disallowed when that film had been sold for only $50,000 during the prior year), aff’d, 722 F.2d 695 (11th Cir. 1984); Hager v. Commissioner, 76 T.C. 759 (1981) (losses for a venture were disallowed where investors paid approximately $15,000 per head for exotic breeding cattle but only approximately $2,000-$3,000 per head had been paid by the direct importers). Deductions have also been disallowed when shelters have been discovered to be complete shams. See, e.g., Surloff v. Commissioner, 81 T.C. 210 (1983) (coal mining venture claimed deductions for advance royalties on all coal deemed to be recoverable when no coal ever was mined).
95. Id. at 1044. William Freschi, Sr., the father of the plaintiff, was seeking a tax shelter for $2,700,000 he had realized from the sale of his interest in a business. He initially established a trust with his son as trustee. Id. at 1043.
96. Id. at 1045. Tax deductions claimed for 1977 and 1978 were $520,000. These deductions reduced taxes by $337,034 and $322,813, respectively, on the senior Freschi’s tax return. Because Freschi’s father was the sole beneficiary of the trust, all taxes were assessed directly against the senior Freschi, but were paid by the trust. Id.
97. Id.
98. Id. The senior Freschi was allowed to offset the investment loss against his other income for that year, resulting in substantial tax savings. See id.
represented the additional tax assessed by the IRS plus the cost of the original investment. But, the trial judge disallowed that part of the award based on increased tax liability and offered the plaintiff remittitur to $266,500, the amount of his original investment without reduction for tax benefits. The plaintiff cross-appealed, claiming damages as a result of the adverse tax consequences which he would have avoided if the investment had been a legitimate tax shelter.

The Second Circuit Court, taking into consideration the tax benefits associated with the deduction of the investment loss, calculated the plaintiff's actual out-of-pocket loss to be only $77,818 and denied the plaintiff's request for additional damages. The court stated, "[A]ny award in compensation for hoped-for tax savings would be an impermissible award of damages arising from an expectation interest[,]" and concluded by instructing that the plaintiff be offered a choice between damages of $77,818 plus prejudgment interest, or a new trial. Thus, tax benefits received may be used to reduce damages, but tax benefits bargained for but not received may not always be recovered as damages.

In its process of interpreting the language in section 28(a) which limits recovery to "actual damages," a court will generally focus on the injury suffered by the plaintiff rather than the benefit reaped by the defendant. This limited focus can be seen in the Salcer decision—the defendant is permitted to benefit from that part of the investment which was essentially "financed" by the government by means of the tax deductions the plaintiff was allowed to take. It appears that the effect of the

99. See id. at 1045-46 (court did not specify what the damages represented; this is inferred from the figures given — $659,846 and $266,500).
100. Id. at 1046.
101. Id. at 1051. The plaintiff was asserting the "dual-motive" nature of a tax shelter investment. The senior Freschi had lost not only his investment, but also the anticipated capital appreciation and projected tax benefits associated with the investment. See supra note 81 and accompanying text.
102. Freschi, 767 F.2d at 1051. The court subtracted the tax savings of $188,682 from the investment loss of $266,500 to arrive at the net loss figure of $77,818. See id.
103. Id.
104. Id. (citations omitted).
105. Id. The court awarded prejudgment interest only on $77,818, based on the assumption that the IRS did not charge interest on the $266,500 loss deduction allowed to Freschi. Id. at 1051 & n.12.
106. The relevant language of section 28(a) of the Securities Exchange Act of 1934 can be found in the text accompanying supra note 85. Although courts generally focus solely upon the plaintiff's injuries, the defendant's benefits may be taken into account under certain circumstances. See supra note 85 (Supreme Court cases holding plaintiff entitled to such "windfall damages").
107. See Salcer, 744 F.2d 935 passim. The damages award, for which the defendant is liable, is reduced by any economic benefits actually received by the plaintiff. For further explanation of how the tax deductions permit the investor to benefit economically, see supra note 49.
"actual damages" limitation is to leave the government "holding the bag," or in the terms of the Burgess court, the government is made "the banker for fraudulent tax shelter activity." 108

2. The "Tax Benefit Rule"

The "tax benefit rule" provides that if an amount which was deducted from gross income in a prior year is recovered in a later year, the amount recovered is gross income in the later year. 109 The Ninth Circuit Court, in Burgess, chose not to reduce damages by tax benefits received because, as the court stated, "[t]he [plaintiffs would] not receive a double benefit from this measure of damages because under the tax benefit rule, their prior tax benefits [would] be disallowed." 110 Yet, in Salcer, the Second Circuit Court rejected this argument when it was presented by the Justice Department. The rationale of the Second Circuit Court was that the form of damages sought in Salcer would negate the application of the tax benefit rule. 111

In Salcer, the plaintiffs sought, and were permitted to obtain, rescissory damages. 112 The Second Circuit Court thus was able to distinguish the case before it from Burgess—the plaintiffs in Burgess sought, and were awarded, rescission. 113 Unfortunately, the distinction fades when analyzed vis-à-vis the tax benefit rule. Rescission—of a contract, for example—is the "undoing of it from the beginning, and not merely a termination . . . It necessarily involves a repudiation of the contract and a refusal of the moving party to be further bound by it." 114 But, rescission

108. Burgess, 727 F.2d at 838.
109. See I.R.C. § 111 (1982). Although section 111 only specifically enumerates bad debts, prior taxes, and delinquency amounts, it is applicable to "all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years." Treas. Reg. § 1.111-1 (1981).
110. Burgess, 727 F.2d at 838. The court in Burgess incorrectly concluded that the plaintiffs would be required to file amended returns in order to effectuate the tax benefit rule. The correct application of the rule is to require that the money judgment be reported as income in the year of receipt. See supra note 109 and accompanying text.
111. Salcer, 744 F.2d at 935.
112. Id. at 938.
113. Burgess, 727 F.2d at 838.
114. BLACK'S LAW DICTIONARY 1174 (5th ed. 1979) (citations omitted). The basis for permitting rescission in rule 10b-5 actions is found in section 29(b) of the Securities Exchange Act of 1934 which states:

Every contract made in violation of any provision of [the 1934 Act] or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of [the 1934 Act] or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any
alone rarely compensates the injured party after the transaction has been completed. Therefore, a plaintiff's restitutional rights must be considered along with rescission. These restitutional rights are specific restitution and rescissory damages.

In Salcer, the plaintiffs sought rescissory damages in the form of recoupment of the investment loss suffered due to the forced sale of the apartment complex. In Burgess, the plaintiffs sought rescissory damages in the form of recoupment of their original investment, although they too had suffered an investment loss on sale of their cattle. Yet, the Second Circuit Court inferred that the damages sought by the plaintiffs in Salcer, if awarded, would not be subject to inclusion under the tax benefit rule due to the “inconsistent/unexpected” distinction applicable to the tax benefit rule as set forth by the Supreme Court in Hillsboro National Bank v. Commissioner.

In Hillsboro, the Supreme Court held that the tax benefit rule should only apply when a “later event is indeed fundamentally inconsistent with the premise on which the deduction was initially based.” The Court

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115. See generally A. Jacobs, supra note 70, § 260.03(c)(vi) (rescission, restitution, and equivalent damages).

116. Restitution is “the act of making good or giving equivalent for any loss, damage or injury . . . . Restoration of status quo and [the] amount which would put plaintiff in as good a position as he would have been [had the transaction never occurred] and [restoration] of what he parted with [during performance].” Black's Law Dictionary 1180 (5th ed. 1979).

117. Rescissory damages are given to return the “injured party to the position he occupied before he was induced by wrongful conduct to enter into the transaction. When return of the specific property, right, etc. is not possible . . . , the rescissory damages would be the monetary equivalent . . . .” Black’s Law Dictionary 679 (abr. 5th ed. 1983); see also A. Jacobs, supra note 70, § 260.03(c)(vi).

Some courts use the term “out-of-pocket damages” interchangeably with “rescissory damages” because, “[w]hen the defendant returns that which he obtained by fraud he also puts the plaintiff back in the position he was in before the fraudulent transaction.” Thompson, supra note 76, at 375 (article highlights the inconsistent application of the term “rescissory damages” to rule 10b-5 cases).

118. Salcer, 744 F.2d at 938. See supra note 117 for a definition of rescissory damages.

119. Burgess, 727 F.2d at 830, 838. See supra note 117 for a definition of rescissory damages.

120. See infra notes 124-25 and accompanying text.

121. Salcer, 744 F.2d at 943.

122. 460 U.S. 370 (1983). In Hillsboro, the IRS had assessed a deficiency against a bank when the bank recognized no income after it had taken a deduction in a prior year for taxes imposed on its shareholders and paid by the bank. Id. at 374. The shareholders were subsequently granted a refund of those taxes when Illinois declared the tax unconstitutional. Id. at 373. The Supreme Court reversed the Tax Court and the Seventh Circuit Court and held that the tax benefit rule did not require a corporation to recognize income where it had paid disputed taxes for shareholders which were subsequently refunded. Id. at 402.

123. Id. at 383 (emphasis added).
also attempted to distinguish an inconsistent event from a merely unexpected event, the latter not invoking the tax benefit rule. It held, “[O]nly if the occurrence of the event in the earlier year would have resulted in the disallowance of the deduction can the Commissioner [of Internal Revenue] require a compensatory recognition of income when the event occurs in the later year.”

The Supreme Court recognized the potential difficulty in applying the “inconsistent/unexpected” test and stated:

[T]he tax benefit rule must be applied on a case-by-case basis. A court must consider the facts and circumstances of each case in the light of the purpose and function of the provisions granting the deductions. . . .

When the later event takes place in the context of a nonrecognition provision of the [Internal Revenue] Code, there will be an inherent tension between the tax benefit rule and the nonrecognition provision. . . . We cannot resolve that tension with a blanket rule that the tax benefit rule will always prevail. Instead, we must focus on the particular provisions of the Code at issue in any case.

In Salcer and Burgess, each court presumably determined the applicability of the tax benefit rule by considering all the facts and circumstances of the case before it vis-à-vis the reasons behind the relevant income tax deduction provisions. In Burgess, the Ninth Circuit Court recognized that the damages award granting rescission of the contract would invoke the tax benefit rule. In Salcer, however, the Second Circuit Court failed to recognize that the damages award granting recoupment of a previous investment loss could also require ordinary income recognition.

In the Salcer opinion, the Second Circuit Court did not indicate

124. Id. at 389 (emphasis in original).
125. Id. at 385-86 (citations omitted).
126. See Burgess, 727 F.2d at 838. Accordingly, the court refused to reduce the damages award by the tax benefits. Id. In Austin v. Loftsgaarden, however, the Eighth Circuit Court dealt with the tax benefit rule in a different manner when it granted damages representing rescission of the contract. The en banc decision of the court in Austin awarded the plaintiffs damages equal to their original investment plus interest, but minus tax benefits. The court then doubled this amount because it “assume[d] that each plaintiff [was] still in the fifty percent tax bracket and thus [had to] receive twice the above amount of damages and net interest cost.” Austin v. Loftsgaarden, 768 F.2d 949, 960-61 (8th Cir. 1985), cert. granted sub nom. Randall v. Loftsgaarden, 54 U.S.L.W. 3328 (U.S. Nov. 12, 1985) (No. 84-519). The effect of the “doubling” of the award was to compensate the plaintiffs for the impact of the tax benefit rule. Yet, as the dissenting opinion pointed out, “Rather than making up an artificial theory of damage by doubling the net gain, it is much simpler and more accurate to provide the plaintiff with restitution of his investment.” Id. at 963 (Lay & Bright, JJ., dissenting). The dissenting opinion also pointed out the potential “recapture” rules that may be invoked by I.R.C. § 1245 (1982), which require ordinary income recapture for depreciation taken on assets sold at a gain. See Rev. Rul. 80-58, 1980-1 C.B. 181 (IRS treated rescission as independent transaction if it occurs in year subsequent to year of original investment).
whether the plaintiffs were entitled to a deductible investment loss on their individual tax returns at the time of the forced sale of their partnership interests. If such an investment loss were allowed, recoupment of that loss through a subsequent damages award would seem to invoke the tax benefit rule. If, on the other hand, a taxable gain were to result from the forced sale, the damages award would appear to represent additional gain requiring income recognition.127

3. The Government’s Role as “Third Party Investor” and the Effect of the Tax Benefit Rule

Although the role of the government in tax shelter investments was not sufficiently significant to invoke the collateral source rule in Salcer,128 an accurate analysis of the tax shelter investment must take into consideration the role of the government in such investments. The government provides the tax benefits129 that minimize the investment costs of an investor without necessarily reducing the profit realized by a promoter.130 When damages are reduced by tax benefits received, an investor’s recovery is limited to “actual damages”; the profit realized by a promoter is not reduced, however, and the government does not receive taxes on this “profit” retained by the promoter.131

127. A taxable gain at the time of the forced sale would have resulted if the investors had received more than their adjusted basis (original basis plus certain expenditures, minus certain deductions) in the partnership units sold. See I.R.C. §§ 1001, 1006 (1982).

128. Salcer, 744 F.2d at 941-42. The collateral source rule prevents the introduction of evidence pertaining to benefits received by the plaintiff from sources independent of the transaction at issue. The rationale is that defendants should not be permitted an offset against damages claimed by plaintiffs merely due to the fact that plaintiffs receive compensation from an independent source. See, e.g., Majestic v. Louisville & N.R. Co., 147 F.2d 621, 627 (6th Cir. 1945). In Salcer, the court refused the application of the collateral source rule under the circumstances; it reasoned that tax benefits (the “collateral source” for the Salcer plaintiffs) are not independent, as are, for example, insurance policy benefits, which are obtained through independent negotiations by a policyholder. Instead, tax benefits result directly from tax shelters and could not otherwise be realized without the shelters.

129. See supra note 30 and accompanying text.

130. Promoters have the use of funds which generate tax deductions, such as depreciation, but do not affect cash flow. The dissenting opinion in Austin recognized that the defendant had received a profit of at least $100,000 from the investment scheme and had gained both “his own profit from the scheme and the advantage of plaintiffs’ speculative tax benefits” that reduced the plaintiffs’ award. Austin v. Loftsgaarden, 768 F.2d 949, 963 (8th Cir. 1985) (Lay & Bright, JJ., dissenting), cert. granted sub nom. Randall v. Loftsgaarden, 54 U.S.L.W. 3328 (U.S. Nov. 12, 1985) (No. 85-519).

131. For example, if an investor invests $100 in a tax shelter and receives a tax benefit of $50, his net cost is only $50. The promoter of the tax shelter, however, has received the benefit of the full
When damages are not reduced by tax benefits received, a different allocation among the parties results. An investor is not necessarily limited to “actual damages,” but the government is “reimbursed” due to its collection of taxes on this amount pursuant to the tax benefit rule. In this scenario, a promoter, the “wrongdoer” in the transaction, does not enjoy the benefit of being placed in a better position than the other parties to the investment.

V. APPLYING THE SALCER DECISION TO FUTURE CASES

A. The Effect of Future Disallowance of Tax Benefits

In Salcer, the Second Circuit Court rejected the Justice Department’s argument that tax benefits should not reduce damage awards because they are “illusory” in nature. The court found that “the mere possibility that the I.R.S. may later challenge the plaintiffs’ tax benefits [was] not sufficient for [it] . . . simply to ignore those benefits. There must first be some showing of facts [in the case before the court] that would justify such a challenge by the I.R.S.”

The court implied that potential disallowance should be considered if more than a “mere possibility” of challenge by the IRS existed. Considering the recent crackdown on tax shelter investments by the IRS, there is an increased possibility that such a challenge may be thrust on tax shelter investors.

An inequitable result occurs if tax benefits are disallowed after the investor has been awarded damages: undercompensation for the investor, actual damages recovery for the government, and overcompensation for the defendant promoter. Once again, the “wrongdoer” promoter would be left in a better position than the other parties to the transaction. Perhaps the only viable solution is for the investor to bring suit after the “mere possibility” of disallowance is extinguished.

100. If the damages award is paid by the promoter net of the investor’s tax benefit, the promoter appears to be $50 better off.

132. If the damages award is not reduced by the investor’s tax benefits, the promoter must pay back the full $100 of the investor’s money. Assuming the investor is in the same tax bracket as he or she was in the year of investment and the tax benefit rule is applicable, the investor will pay taxes of $50. The net result is that no party to the transaction is placed in a better position than he or she held before entering into the transaction.

133. Salcer, 744 F.2d at 942.

134. See supra notes 13-14.

135. See supra notes 131-32 and accompanying text.

136. Id.

137. Generally, the IRS must assess a tax within three years after a tax return has been filed. See I.R.C. § 6501(a) (1982). A special six year statute of limitations applies, however, if a taxpayer...
B. Effect on State Claims of a Similar Nature

Investors may opt to file a claim for damages under local state laws or under rule 10b-5. At the state level, under common law, advantageous factors to consider include the availability of punitive damages and the possibility of greater compensatory damages. Common law damages, however, are more difficult to prove than a rule 10b-5 breach. The Salcer decision has added an additional factor to be considered by potential litigants.

This additional factor was illustrated in a recent case before the Third Circuit Court, Eisenberg v. Gagnon. In Eisenberg, the plaintiffs were involved in a series of limited partnerships designed as tax shelters. The investments proved worthless and the IRS disallowed all deductions other than the actual monetary loss associated with the investment itself. The jury awarded the plaintiffs the sum of their investment plus the interest paid to the IRS due to the disallowance of deductions under a common law claim of negligence.

On appeal, the defendants argued that the jury should have reduced the award by fifty percent because the ultimate loss on the investment and the interest paid were deductible tax items. But, the Pennsylvania Supreme Court had held in Gradel v. Inouye that "[i]ncome tax as it relates to damages should be mentioned neither in argument nor in jury instructions." Thus, the Third Circuit Court rejected the defendant's argument and held that the "jury's determination was consistent with Pennsylvania law regarding the tax consequences of injuries from negligence." It did not decide whether the result would have been different if the claim had arisen under federal securities laws.

138. See A. Jacobs, supra note 70, § 260.03(a).
140. See A. Jacobs, supra note 70, § 260.03(c). Some courts will not award "benefit-of-the-bargain" damages in rule 10b-5 actions. See id. § 260.03(c)(v).
141. See id. § 260.03(a).
142. 766 F.2d 770 (3d Cir. 1985).
143. Id. at 773.
144. Id.
145. Id. at 774, 782.
146. Id. at 782.
147. 491 Pa. 534, 421 A.2d 674 (1980).
148. Id. at 547, 421 A.2d at 680, quoted in Eisenberg, 766 F.2d at 782.
149. Eisenberg, 766 F.2d at 782.
150. Id.
A similar issue was before the United States District Court for the Southern District of New York in *Felkay v. ZB Limited Partnership No. 1*. The district court in *Felkay* did not address the defendant's argument that damages should be reduced by economic benefits such as tax deductions since relief was granted to the plaintiff investors under contract law.

The dilemma of state courts not applying the holding in *Salcer* because of the type of claim filed would parallel the trend in personal injury and wrongful death actions established after the holding in *Norfolk & Western Railway v. Liepelt* that juries must be instructed regarding the tax treatment of personal injury damage awards filed under the Federal Employers Liability Act.

**C. The Status of Oklahoma Law**

In *Feldman v. Pioneer Petroleum, Inc.*, a recent case before the United States District Court for the Western District of Oklahoma, the district court dismissed the plaintiffs' claim in part because tax benefits received from the investment exceeded the plaintiffs' claimed loss. The tax shelter investment involved in *Feldman* was a working interest in an oil and gas lease. Approximately ninety percent of the capital contributed by the investors was allocated to intangible drilling and development costs entitling each investor to deduct ninety percent of his investment for income tax purposes. A second-tier partnership based on nonrecourse loan financing entitled each participating investor to

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152. *Id.; see also Hayden v. McDonald*, 742 F.2d 423, 440 (8th Cir. 1984) (court refused to reduce damages by tax benefits received because claim was brought as a result of nonregistration of securities under the Minnesota Blue Sky Act), *overruled*, Austin v. Loffsgaarden, 768 F.2d 949, 953 n.6 (8th Cir. 1985), *cert. granted sub nom.* Randall v. Loffsgaarden, 54 U.S.L.W. 3328 (U.S. Nov. 12, 1985) (No. 85-519). *But see Hall v. Johnson*, 758 F.2d 421, 424 (9th Cir. 1985) (application of holdings of federal securities fraud cases to an action brought pursuant to Oregon's statutorily based securities law; court refused to reduce damages by tax benefits generated by the investment).

153. 444 U.S. 490 (1980); *see also supra* note 31.

154. *See supra* note 31 for a discussion of jury instructions regarding the tax treatment of damage awards.


156. *Id.* at 923-24.

157. *Id.* at 918.

158. *Id.* Intangible drilling costs are those costs that have no salvage value and are incurred in drilling, equipping, and operating the well. The costs may be deducted as incurred, rather than depreciated over a period of time, thus providing substantial tax benefits. R. Tannenhauser & C. Tannenhauser, *supra* note 29, at 145.


160. For a definition of a nonrecourse loan, *see supra* note 28.
an additional income tax deduction equal to ninety percent of his investment.\textsuperscript{161} Thus, an investment of $10,000 in the first-tier partnership accompanied by an election to participate in the second-tier partnership would yield the investor tax deductions in the amount of $18,000.\textsuperscript{162}

The district court recognized the IRS had audited the plaintiffs' tax returns and had found that the tax shelter was a sham.\textsuperscript{163} But, as of the date of the court's decision, none of the plaintiffs had been required to pay any additional taxes with respect to their 1972 federal income tax returns.\textsuperscript{164}

The district court further recognized that if the IRS were to subsequently disallow the deductions associated with the investment, each plaintiff would still be allowed a loss deduction in the amount of his original investment—a tax benefit to the investor. But, the tax benefits received from the loss deduction would be less than tax benefits received if the original deductions associated with the investment had been allowed.\textsuperscript{165} The court refused to allow this difference as damages, however, due to the purely "speculative" nature of the settlement.\textsuperscript{166}

In summary, the court reasoned that plaintiff Feldman had actually retained an $80,000 profit, based on his $200,000 investment which had provided $250,000 in tax benefits and $30,000 in income.\textsuperscript{167} Based on this fact, the court concluded "that the Plaintiffs [had] failed to prove they [had] suffered actual loss even though the tax benefits promised in the Prospectus may not materialize."\textsuperscript{168}

\section*{VI. CONCLUSION}

The Salcer decision effectuated the "actual damages" limitation, which is provided in section 28(a) of the Securities Exchange Act of 1934, but failed to consider the dual motives of the investor who is entering into a tax shelter investment. The decision also failed to give adequate deference to the unique triangular nature of tax shelter investments: it failed to recognize the importance of the role of the gov-

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\textsuperscript{161} Feldman, 606 F. Supp. at 918.  \\
\textsuperscript{162} Id.  \\
\textsuperscript{163} Id. at 923.  \\
\textsuperscript{164} Id. at 923-24. Tax disputes involving investors in the case at hand had been designated by the IRS as "settlement vehicles," meaning the IRS is attempting to settle the disputes by offering to allow 100\% of each investment as a deduction to the investor. Id. at 924.  \\
\textsuperscript{165} Id. at 924.  \\
\textsuperscript{166} Id.  \\
\textsuperscript{167} Id.  \\
\textsuperscript{168} Id. 
\end{flushleft}
ernment as the “third party investor” who provides the controversial tax benefits in tax shelter investments.

The effect of the decision is to benefit the promoter through reduced damage awards—unfortunately at the government's expense—with the potential risk of minimizing the deterrent aspect of the securities laws. The better solution is federal tax reform which would curtail the abusive nature of tax shelter investments. Also, proper application of the tax benefit rule would tax, as income, the damages award received by an investor, thus more closely effectuating a compensatory damages award for all parties involved.

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