SECURITIES

TAX SHELTER SCHEMES AND DAMAGES IN THE EIGHTH CIRCUIT—HAYDEN v. MCDONALD

INTRODUCTION

Although the increasing use of tax sheltered investments has proven beneficial to many individuals, such investments carry with them the possibility that the investor may be forced to resort to litigation to recover monies lost through the fault of the promoter. One issue which has arisen from such investor litigation is whether a plaintiff/investor's recovery must be "offset" by the amount of tax benefits recovered by the investor. Courts addressing this question have split on the issue.1

In Hayden v. McDonald,2 the Eighth Circuit Court of Appeals realigned its earlier decision in Austin v. Loftsgaarden3 where the court held that evidence of tax benefits received must be considered in determining a plaintiff/investor's damages.4 The Eighth Circuit in Hayden reaffirmed the Austin decision and stated further that both past tax benefits and future tax consequences are relevant in determining a plaintiff's actual damages in tax shelter litigation.5

It is the purpose of this Note to evaluate the Austin and Hayden decisions and to discuss ramifications these cases may have on the status of the award of damages in tax shelter cases in the Eighth Circuit. To accomplish this, this Note discusses federal circuit court cases that have dealt with the issue of damages in the sheltered investments, analyzes the district court's and the Eighth Circuit's handling of the damages issue in Hayden, discusses the positions recently taken by the IRS, the SEC, and the Second Circuit Court of Appeals, and discusses the overall implications for practitioners in the Eighth Circuit. The Note concludes that the Eighth Circuit's interpretation of federal securities law reaches the better result and suggests that such interpretation should apply as well to causes of action based on state securities laws.

1. See, e.g., Salcer v. Environ Equities Corp., 744 F.2d 935 (2d Cir. 1984); Hayden v. McDonald, 742 F.2d 423 (8th Cir. 1984); Western Fed. Corp. v. Davis, 739 F.2d 1439 (9th Cir. 1984); Burgess v. Premier Corp., 727 F.2d 826 (9th Cir. 1984); Austin v. Loftsgaarden, 675 F.2d 168 (8th Cir. 1982).
2. 742 F.2d 423 (8th Cir. 1984).
3. 675 F.2d 168 (8th Cir. 1982).
4. Id. at 183-84.
5. Hayden, 742 F.2d at 447.
FACTS AND HOLDING

The plaintiffs in Hayden purchased several undivided working interests in oil and gas leases during the period from October, 1977, to June, 1980.6 None of these interests was registered under the Minnesota securities laws or the federal securities laws.7 Toward the end of 1980, the oil and gas leases stopped being productive and several

6. Hayden v. McDonald, 742 F.2d 423, 427 (8th Cir. 1984). See also Brief for Appellants at 8-9, Hayden. From October, 1977, to June, 1980, the plaintiffs purchased 293 separate undivided interests in a large number of wells. Each purchase was treated separately by having each plaintiff execute three documents: (1) a Private Placement Agreement, which basically described the oil and gas lease and set out the rights and obligations of the parties involved; (2) an Operating Agreement, which imposed upon the defendant the obligation to drill the well; and (3) a Disclosure Acknowledgement Agreement, which, among other things, acknowledged that the purchased interest would not be registered under either federal or state securities laws. Hayden, 742 F.2d at 427.

7. The plaintiffs had at least constructive knowledge of the nonregistration because the Disclosure Acknowledgement Agreement, signed by the plaintiffs, indicated that the interests would not be registered. Id. The relevant Minnesota statutes are:

1. MINN. STAT. ANN. § 80A.08 (West Supp. 1984) (registration requirement):
   “It is unlawful for any person to offer or sell any security in this state unless (a) it is registered under sections 80A.01 to 80A.31 or (b) the security or transaction is exempted under section 80A.15.”

2. MINN. STAT. ANN. § 80A.30 (West Supp. 1984) (registration of oil or gas lands or interest before sale):
   Subdivision 1. No person shall sell to any person in this state any lands represented to contain or to be a prospect for oil or gas, or any interest therein or thereunder, or in royalties therefrom, unless and until those lands, interests or royalties shall have been first registered under this chapter. Registration shall be made or denied in substantially the same manner and upon substantially the same grounds and conditions as are prescribed for the registration of securities by section 80A.11. The fees for registration shall be calculated in the same manner as the fees for registration of securities under section 80A.28, subdivision 1.

   Subdivision 2. This section will not apply to any isolated sale not made or occurring in the course of repeated or successive sales; nor to any judicial sale or any transaction lawfully ordered, authorized, or approved by a court of competent jurisdiction in this state; nor to any sale to a bank or financial institution under the supervision of any instrumentality or officer of the United States or of the commissioner of banks or of the commissioner of insurance of this state, or a licensed broker-dealer; nor to any sale made in compliance with the provisions of section 80A.15, subdivision 2, clause (h). In any complaint, information or indictment charging a sale in violation of this section, it shall not be necessary to specifically name or identify persons other than the complainant to whom like sales have been made.

   The relevant federal securities law is section 5(c) of the Securities Act of 1933, 15 U.S.C. § 77e(c), which provides:

   It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order to stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77 of this title.
wells began to be abandoned or shut down.\textsuperscript{8} Plaintiffs subsequently filed suit in United States District Court for the District of Minnesota.\textsuperscript{9} The cause of action was based on a Minnesota statute that permits plaintiffs, in an action for the nonregistration of securities in Minnesota, to recover the consideration paid for the security less the amount of income received.\textsuperscript{10}

The defendants in \textit{Hayden} argued to the district court that it should follow the recent decision of the Eighth Circuit in \textit{Austin v. Loftsgaarden}\textsuperscript{11} and consider the tax benefits received by the plaintiffs as "income" for purposes of the Minnesota statute.\textsuperscript{12} In refusing to consider tax benefits in determining the award, the district court distinguished \textit{Hayden} from \textit{Austin} by stating that in \textit{Hayden}, the plaintiffs did not receive the "primary benefit" from the investment in the form of tax breaks and the venture was not marketed "solely as a tax shelter."\textsuperscript{13} The district court awarded the plaintiffs over 3.2 million dollars in damages for the defendants' failure to register the interests in the oil and gas leases as required by the Minnesota Blue Sky Act.\textsuperscript{14} On appeal to the Eighth Circuit, the defendants argued

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\item \textsuperscript{8} Brief for Appellants at 12, \textit{Hayden}.
\item \textsuperscript{9} Hayden v. McDonald, No. 80-620, slip op (D. Minn. Dec. 14, 1982). The plaintiffs initially filed four separate complaints in the United States District Court for the District of Minnesota, alleging numerous violations of both federal and state securities laws. While the cases were consolidated by the district court, the issue of nonregistration under the Minnesota Blue Sky Act, MINN. STAT. ANN. § 80A.08 (West Supp. 1984), was bifurcated from the other claims in the complaints. The district court's subsequent rulings on the state nonregistration issue were the subject of the appeal. \textit{Hayden}, 742 F.2d at 425.
\item \textsuperscript{10} MINN. STAT. ANN. § 80A.23(1) (West Supp. 1984) provides that "the purchaser shall be entitled to recover the consideration paid for the security together with interest at the legal rate, costs and reasonable attorney's fees, less the amount of any income received on the securities."
\item \textsuperscript{11} 675 F.2d 168 (8th Cir. 1982).
\item \textsuperscript{12} Hayden v. McDonald, No. 80-620, slip op. (D. Minn. Dec. 14, 1982). The Eighth Circuit in \textit{Austin} held that, for purposes of both § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77, which has identical language in pertinent part to that in the Minnesota statute and MINN. STAT. ANN. § 80A.23(1) (West Supp. 1984), which provides "[t]he actual damages principle requires that a rescissional or restitutional award be 'reduced by any value received as a result of the fraudulent transaction.'" \textit{Austin}, 675 F.2d at 181 (quoting Garnatz v. Stifel, Nicolaus & Co., 559 F.2d 1357, 1361 (8th Cir. 1977), cert. denied, 435 U.S. 951 (1978)). Accordingly, the Eighth Circuit in \textit{Austin} construed the word "income" in § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77, to include tax considerations and instructed the trial court to allow evidence of the amount of tax benefits received by the plaintiff as a result of the fraudulent transaction. \textit{Austin}, 675 F.2d at 181. The defendants in \textit{Hayden} contended that since the Eighth Circuit had already construed the Minnesota statute and the federal statute together, in stating that the award must be reduced by any value received as a result of the transaction, the interpretation of the word "income" should be the same under both statutes. Brief for Appellants at 37, \textit{Hayden}.
\item \textsuperscript{13} Hayden v. McDonald, No. 80-620, slip op. at 7 (D. Minn. Dec. 14, 1982).
\item \textsuperscript{14} \textit{Hayden}, 742 F.2d at 427. The district court appointed a special tax consultant to analyze the past tax benefits received by the plaintiffs and the future tax conse-
that the facts in *Austin* were indistinguishable from the facts in *Hayden*. Therefore, the defendants reasoned, the district court should have reduced the plaintiffs' recovery by the amount of tax benefits they received from the investment.\(^\text{15}\) Initially, the *Hayden* court reaffirmed its prior holding in *Austin* and stated that if *Austin* were to apply to the present situation, the court would consider both the past tax benefits received by the plaintiffs as well as future tax consequences of recovery in computing damages.\(^\text{16}\) However, the Eighth Circuit refused to apply *Austin*, stating that it would defer to the district court's interpretation of the word "income" for purposes of the Minnesota statute.\(^\text{17}\) Thus, the Eighth Circuit affirmed the district court's refusal to consider tax benefits received by plaintiffs in awarding damages.\(^\text{18}\)

Chief Judge Lay, in a concurring opinion, stated that although he agreed with the result, he could not agree with its reasoning.\(^\text{19}\) He contended that the majority had drawn a meaningless distinction between state and federal securities laws to prevent the tax benefits from being considered.\(^\text{20}\) Nevertheless, Chief Judge Lay concurred with the majority because, in his opinion, *Austin* was wrongly decided.\(^\text{21}\)

**BACKGROUND**

The first circuit court to deal with the offset rule was the Eighth Circuit in *Austin v. Loftsgaarden*.\(^\text{22}\) *Austin* was an action based on section 10(b) of the Securities Exchange Act of 1934,\(^\text{23}\) Rule 10b-5,\(^\text{24}\)
the antifraud provisions of the Minnesota Securities Act, and common law fraud, for misrepresentations and omissions found to exist in the offering memorandum used to attract plaintiffs to invest in a real estate tax shelter. The purpose of the real estate project was to build a hotel in Minnesota which was partially financed through a limited partnership in which the plaintiffs had invested. The offering memorandum stated that the partnership would "operate as a 'tax shelter,'" leading to "significantly greater returns for persons in relatively high income brackets." Ultimately, the project failed as a result of costs incurred that were greatly in excess of those projected in the offering memorandum.

At the district court level, the jury found the defendants liable on all claims and also rendered an advisory opinion, in which the district court concurred, that the defendants were liable for violating section 12(2) of the Securities Act of 1933. The defendant attempted to show that the plaintiffs suffered no actual harm because

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   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentalities 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.

26. Austin, 675 F.2d at 172.
27. Id. at 173.
28. Id.
29. Id. at 174.
30. Id. at 172. An advisory opinion is "[a] formal opinion by a judge or judges or a court or a law officer upon a question of law submitted by a legislative body or a governmental official, but not actually presented in a concrete case at law." Douglas Oil Co. v. State, 81 S.W.2d 1064, 1077 (Tex. Civ. App. 1935).

Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l(2) provides in pertinent part:

   Any person who—
   (2) offers or sells a security . . . , by the use of any means or instrumentalities or transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either in law or in equity in any court for competent jurisdiction, to recover the consideration paid for such security with interest
of the large tax write-offs that the plaintiffs had received. The district court, however, would not allow such proof because, as the court put it, it was “not going to get into a lot of complicated tax testimony.”31 The court dismissed the defendants’ argument as “sophisticated malarky.”32

On appeal, the Eighth Circuit reversed and held that “in a private securities fraud action involving an investment structured and marketed as a tax shelter, where a rescissory measure of damages is applied, evidence of any benefit derived by the plaintiff/investor via tax savings must be permitted.”33 The Eighth Circuit limited the scope of its holding to those investments expressly marketed and sold as tax shelters.34 In response to the plaintiffs’ argument that the IRS was auditing the past returns and that the past tax deductions might be disallowed, the Eighth Circuit stated that the possibility of the disallowance was relevant to the determination of any benefits actually received by the plaintiff. Accordingly, the court held that the jury was entitled to determine to what extent there would be a disallowance of the deductions.35

In March of 1984, the Ninth Circuit decided Burgess v. Premier Corp.,36 in which the court refused to offset the plaintiffs’ damages by the amount of the tax benefit received.37 The plaintiffs in Burgess were doctors from Seattle, Washington, who had purchased tax shelter investments in cattle herds from Premier.38 Premier sold the cattle to the plaintiff/investors who then entered into management contracts with Premier.39 Each doctor claimed extensive income tax deductions for the purchase, maintenance, and depreciation of his herd.40 After losing a substantial amount of money, the investors brought suit based on section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5, common law fraud, and Washington securities laws, claiming that Premier had failed to disclose several material facts regarding the operation.41

In reaching its decision, the Ninth Circuit acknowledged the holding in Austin but refused to follow the decision for two reasons.

31. Austin, 675 F.2d at 181.
32. Id.
33. Id. at 183-84.
34. Id. at 183.
35. Id.
36. 727 F.2d 826 (9th Cir. 1984).
37. Id. at 837-38.
38. Id. at 830.
39. Id.
40. Id.
41. Id. See also notes 23-24 supra.
First, the court felt that under the tax benefit rule, the prior tax benefits would be disallowed once the plaintiffs recovered on their judgments. The Ninth Circuit indicated that it would presume that the IRS would "do its duty" if the doctors recovered on their investments and thereafter failed to file amended returns as required by law. By the phrase "do its duty," the court was referring to the IRS's ability to audit returns and force the plaintiffs to declare as income the deductions previously taken and now taxable as income as a result of recovery on their investment. Second, the court stated that to allow the defendant to offset the plaintiffs' recovery by the tax benefits derived would in effect "make the government the banker for the fraudulent tax shelter activity." Thus, the Ninth Circuit declined to follow the result reached in Austin because the court indicated it would presume the IRS would disallow the deductions and to hold otherwise would permit the defendant to profit at the expense of the plaintiffs and the government.

In July of 1984, the United States District Court for the Southern District of New York decided Freschi v. Grand Coal Venture, in which the court held that the Ninth Circuit's analysis in Burgess was preferable to the Eighth Circuit's analysis in Austin and, therefore, refused to consider the tax benefits received by the plaintiff. The court stated that "[w]hen a plaintiff has his investment returned to him in a damage award, the tax laws result in the disallowance of the deductions he took on the investments, eliminating much or all of the tax benefits." The court indicated that if this effect were ignored, the losers would be the government and the plaintiff, while the only winner would be the defendant.

42. Id. at 838. Under the tax benefit rule, when a deduction is followed in a subsequent year by a recovery of the previously deducted liability (expense, loss, bad debt, or other item), the taxpayer must treat the recovery as taxable income. J. MERTENS, THE LAW OF FEDERAL INCOME TAX §§ 7.34-7.37 (1984).

43. Burgess, 727 F.2d at 838.

44. It can be argued that the Ninth Circuit erroneously assumed that amended returns are required when the tax benefit rule is applied. Arguably, a better application of the tax benefit rule requires not that the plaintiffs file an amended return but that the money judgment be reported as taxable income for the current year. See Salcer v. Environ Equities Corp., 744 F.2d 935, 943 (2d Cir. 1984) (discussing the Ninth Circuit's erroneous assumption).

45. Burgess, 727 F.2d at 838. Allowing the offset of the plaintiff's damages has two effects: (1) the damages the defendant must pay to the plaintiff are lessened; (2) the government may only tax the plaintiff on the reduced recovery. Thus, the government, in effect, foots the bill for the defendant's misconduct. Id.

46. Id.

47. Id.


49. Id. at 1260.

50. Id. (citing Burgess v. Premier Corp., 727 F.2d 826, 838 (9th Cir. 1984)).

51. Id. See also note 45 supra.
The Ninth Circuit subsequently reaffirmed its position in Burgess when it decided Western Federal Corp. v. Erickson in August of 1984. The defendant/promoters of a silver mining venture argued that the offset rule should apply to reduce the plaintiff's damages. The Ninth Circuit refused to do so, terming the defendants' argument, in light of Burgess, "without merit." Subsequent to Austin, the Ninth Circuit and other jurisdictions rendered decisions contrary to that of the Eighth Circuit's opinion in Austin. These opinions could have been relied upon by the Eighth Circuit as the better law. However, in Hayden the Eighth Circuit was not persuaded by the other jurisdictions and affirmed its Austin position by concluding that both past tax benefits and future tax consequences are relevant in determining damages.

The Eighth Circuit criticized the Ninth Circuit for its assumption that application of the tax benefit rule would automatically cancel out the past tax benefits. The court stated that placing total reliance on the tax benefit rule to wash out the tax consequences was a fallacy. The court indicated that it would accept evidence from both parties as to the total financial benefit realized by the plaintiff. The court also suggested that, contrary to Burgess, the court would not presume that the IRS would act to recover its share of a judicial recovery and that it would accept evidence of present or potential IRS action.

Subsequent to Hayden, the Second Circuit decided Salcer v. Environ Equities Corp., in which the court, despite arguments to the contrary by the SEC and the IRS, permitted the offsetting of the plaintiff's award by the amount of tax benefits received. The opinion was contrary to the position taken by the United States District Court for the Southern District of New York, a court in the Second Circuit, in Freschi. By allowing the offsetting, the court adopted a position similar to that taken by the Eighth Circuit in Hayden.

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52. 739 F.2d 1439 (9th Cir. 1984).
53. Id. at 1444.
54. Id. at 1441, 1444.
55. Id. at 1444.
56. See notes 36–55 and accompanying text supra.
57. See notes 23–35 and accompanying text supra.
58. Hayden, 742 F.2d at 440.
59. Id.
60. Id.
61. Id.
62. Id.
63. 744 F.2d 935 (2d Cir. 1984).
64. Id. at 940–42.
65. See notes 45–51 and accompanying text supra.
66. See note 16 and accompanying text supra.
ANALYSIS

Austin Interpreted and Distinguished

In *Hayden*, the Eighth Circuit was faced with defining "income" under the Minnesota Blue Sky Laws. Previously, under federal law the Eighth Circuit had indicated that income may include tax benefits received by plaintiff/investors. Because the wording of the federal and state statutes was virtually identical and the *Austin* court addressed both federal and state law in its discussion, prior to *Hayden*, it was logical to assume that "income" would include tax benefits under either federal or state law. This assumption proved false, however, because the Eighth Circuit in *Hayden* interpreted *Austin* to apply only to a cause of action brought under federal securities laws. Ironically, as Chief Judge Lay noted in his concurrence, "[t]he majority fails to notice that in interpreting section 772 of the Federal Securities Act the *Austin* court relied upon Minnesota law and cited the Minnesota statute said to be distinguishable." Therefore, as Chief Judge Lay argued, the majority's interpretation of *Austin* was incorrect.

In *Hayden*, the application of *Austin* and the interpretation of "income" by the Eighth Circuit and the district court were inconsistent. The Eighth Circuit found its earlier decision in *Austin* inapplicable and deferred to the district court. The district court, on the other hand, in construing the word "income," relied on *Austin* as

67. See *Hayden*, 742 F.2d at 440. The court followed the district court's definition of "income" for purposes of the state statute.
68. *Austin v. Loftsgaarden*, 675 F.2d 108, 181 (8th Cir. 1982).
69. The court had before it § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77L and MINN. STAT. ANN. § 80A.23 (West Supp. 1984). Section 12(2) of the 1933 Act provides in pertinent part that a defendant guilty of prospectus fraud shall be liable to a plaintiff "who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon . . . ." *Id.* (emphasis added).

The Minnesota statute states that for a violation of the registration requirements, "the purchaser shall be entitled to recover the consideration paid for the security together with interest at the legal rate, costs, and reasonable attorney's fees, less the amount of any income received on the securities." MINN. STAT. ANN. § 80A.23 (West Supp. 1984) (emphasis added).

70. *Austin*, 675 F.2d at 181.
71. See *Hayden*, 742 F.2d at 439-41. The court's decision that the state rather than the federal statute applied leads to the inescapable conclusion that the court drew a distinction between state and federal law. See also *id.* at 441-42 (Lay, C.J., concurring) (stating that the majority opinion created a meaningless distinction between state and federal law).
72. *Id.* at 441.
73. *Id.*
74. *Id.* at 440-41.
75. *Id.*
controlling precedent. The district court interpreted *Austin* as holding that tax benefits received by a plaintiff will be considered as income for reducing damage awards, provided there is: 1) a venture marketed solely as a tax shelter; 2) a single investment purpose of receiving tax benefits; and 3) an investment of which the primary benefit is in the form of a tax break.

The district court attempted to distinguish *Austin* by saying that “the venture here [in *Hayden*] was not marketed solely as a tax shelter. The plaintiffs sought an investment with the dual purpose of receiving tax benefits and a return on their investments.” In *Austin*, the Eighth Circuit indicated that its holding was limited to cases “involving investments that are expressly marketed and sold as tax shelters.” The circuit court did not state that a venture must be marketed solely as a tax shelter before the tax benefits a plaintiff receives from the venture would be reduced from any damage award. To the contrary, *Austin* mandates that once an investment is expressly marketed as a tax shelter, “any economic benefit” will be considered in determining a plaintiff’s damage award.

In addition to not requiring the venture be marketed solely as a tax shelter, the Eighth Circuit in *Austin* did not require that the investment be entered into for the single purpose of receiving tax breaks. The facts in *Austin* support this conclusion since in that case, the investments were made for the dual purposes of receiving tax benefits and receiving income from a profitable venture.

The district court’s attempt to distinguish *Austin* from *Hayden* on the ground that the investors in *Hayden* purchased oil and gas leases for purposes other than tax benefits, while investors in *Austin* purchased the real estate shelter only for tax savings, must fail based on the language and facts of *Austin*. Most tax shelters have the...

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76. Hayden v. McDonald, No. 80-620, slip op. at 7 (D. Minn. Dec. 14, 1982). The district court admitted that *Austin* provided support for the contention that tax benefits should be considered as income, but, after interpreting the scope of the holding, the district court stated that *Austin* was distinguishable. *Id.*

77. *Id.* (emphasis added).

78. *Austin v. Loftsgaarden*, 675 F.2d 168, 183 (8th Cir. 1982).

79. *Id.* By using the term *expressly* rather than *solely*, the court was referring to investment marketed not only for tax benefits but also for the prospects of future income.

80. When the court refers to “any economic benefits,” it is referring to both tax savings and revenues received from the investment.

81. *Austin*, 675 F.2d at 183. The Eighth Circuit in *Austin* stated that “the benefits from a profitable real estate tax shelter investment are two-fold, offering tax savings to the limited partner in its early years and generating income in later years.” The court concluded that, “[t]he ultimate goal, of course, is to establish a positive cash flow and become an income-producing enterprise . . .” *Id.*

82. Hayden v. McDonald, No. 80-620, slip op. at 7 (D. Minn. Dec. 14, 1982).
dual purpose of providing tax benefits in early years and income production in later years. In fact, as the plaintiff in Hayden argued, "[i]t is difficult to imagine any investment which solely provides tax deductions and does not have the dual purpose of eventually producing income. If courts were to apply Austin to investments seeking only tax savings—as the district court did in Hayden—but not to investments seeking both revenue and income production, the practical effect would be that rarely, if ever, would a plaintiff investing in a tax shelter have its damages reduced by the amount of tax benefits received. Because nearly every tax shelter has a dual purpose, the district court's distinction between the two types of investments has little practical application.

Finally, the district court attempted to distinguish Hayden from Austin based on the fact that in Hayden, the plaintiff did not receive the "primary benefit" from the investment in the form of tax breaks. Therefore, the district court reasoned that the tax benefits could not be considered income. The court focused on the fact that the plaintiffs in Austin were able to take loss deductions far in excess of their actual investment, while in Hayden, the plaintiffs were unable to deduct losses to the extent deducted in Austin.

Although a conceptual distinction, the district court's focus on this issue is irrelevant in light of Austin. In Austin, the Eighth Circuit, unlike the district court in Hayden, did not require that the primary benefit from the investment be in the form of tax benefits before the tax benefits would be considered to reduce the plaintiff's damages. To the contrary, the Eighth Circuit held that in cases “involving an investment structured and marketed as a tax shelter, where a rescissory measure of damages is applied, evidence of any benefit derived by the plaintiff/investor via tax savings must be permitted.” Pursuant to Austin, if a venture is marketed as a tax shelter, solely or otherwise, proof of any economic benefits, including tax benefits, received by the plaintiff must be considered income which will reduce an investor's damages. As the defendant in Hayden contended on appeal, “the Austin decision does not rest on the enormity of the tax deductions but on the existence of benefits which

84. See Austin, 675 F.2d at 182. The court refers to real estate tax shelters in the context of this case. All investors, however, look for both tax savings and income generation.
85. Brief for Appellants at 38, Hayden.
86. Hayden, No. 80-620, slip op. at 7.
87. Id.
88. Id.
89. See notes 90-92 and accompanying text infra.
90. Austin, 675 F.2d at 183-84 (emphasis added).
91. Id.
cause rescission damages to be greater than the actual loss."  

In light of this, it appears that the district court's interpretation of Austin and its attempts to distinguish it from Hayden were erroneous. A correct interpretation of Austin would seem to require that once an investment is marketed as a tax shelter, proof of any economic benefit received by the investor will be permitted in assessing damages. Austin does not require that the venture be marketed solely as a tax shelter, nor does it require that receiving tax benefits must be the primary purpose of the investment. Thus, based on Austin, the plaintiff's recovery in Hayden should have been reduced by the tax benefits received.

Eighth Circuit

On appeal, the Eighth Circuit held in Hayden that the district court did not err by failing to adjust the plaintiffs' recovery by the amount of tax benefits received. Since the plaintiffs' recovery was based on the Minnesota Blue Sky Act, the Eighth Circuit stated that it would not overrule the district court's literal interpretation of the term "income" in the state statute. The court suggested, however, that the result would have been different if the plaintiffs' claim had been based on section 12(2) of the Securities Act of 1933. By allowing different results, depending on whether the action is based on virtually identical state or federal securities statutes, the Eighth Circuit has added to the confusion of attempting to interpret two securities acts that are intended to be consistently applied.

The Eighth Circuit's deference to the district court's literal interpretation of the term "income" under the Minnesota Blue Sky Act may have resulted due to the district court's incorrect interpretation the holding in Austin. Since the district court's reading of Austin

92. Brief for Appellants at 38 Hayden. See notes 90-91 and accompanying text supra.
93. See notes 77-92 and accompanying text supra.
94. Austin, 675 F.2d at 183-84 (emphasis added).
95. See notes 77-92 and accompanying text supra.
96. Hayden, 742 F.2d at 440.
98. Hayden, 742 F.2d at 440-41.
99. See id. at 441 (citing Austin v. Loftsgaarden, 675 F.2d 168, 181 (8th Cir. 1982)).
100. MINN. STAT. ANN. § 80A.31 provides that the Minnesota Blue Sky Act "shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation of sections [of the Minnesota Blue Sky Act] with the related federal regulation."
101. See notes 77-92 and accompanying text supra.
was incorrect, it follows that its definition of "income" for purposes of Minnesota law must also be incorrect. An incorrect interpretation of Austin by the district court, however, does not mandate deference by the circuit court. Rather, the Eighth Circuit in Hayden would have been truer to its own precedent had it reversed the district court and offset the plaintiffs' damages by the tax benefits received.

Not only did the Eighth Circuit erroneously defer to the district court, it also interpreted differently two virtually identical securities statutes. The statutory policy contained in the Minnesota Blue Sky Act states that all of the sections in the Act "shall be so construed as to effectuate its general purpose . . . to coordinate the interpretation of the [Minnesota Blue Sky Act] with the related federal regulation." The Eighth Circuit's decision in Hayden apparently failed to comply with the legislative intent of the Minnesota Blue Sky law.

Five states in the Eighth Circuit, including Minnesota, have substantially adopted the Uniform Securities Act. The Act, including the civil liability provisions of section 410(a)(2), provides for recovery of "the consideration paid for the security . . . less the amount of any income received." The remaining two states in the Eighth Circuit, although not adopting the Uniform Securities Act, have language similar to it. Thus, all states in the Eighth Circuit have adopted securities laws that are similar to the Uniform Securities Act.

The Uniform Securities Act, drafted by Professor Louis Loss of

102. See id.
103. See notes 10, 30 and accompanying text supra.
105. Id.
106. The following states in the Eighth Circuit have substantially adopted the Uniform Securities Act and the Civil Liability provisions: (1) ARK. STAT. ANN. §§ 67-1225 to -1224.14 (Repl. 1980); (2) IOWA CODE ANN. §§ 502.10 to -622 (West 1985); (3) MINN. STAT. ANN. §§ 80A.01 to -31 (West 1984); (4) MO. ANN. STAT. §§ 409.101 to -565 (Vernon 1985); and (5) NEB. REV. STAT. §§ 8-1101 to -1124 (Reissue 1983). See 1 BLUE SKY L. REP. (CCH) § 550D (——).
107. 1 BLUE SKY L. REP. (CCH) § 5550 (The Uniform Securities Act provides in § 410 for restitutionary recovery of "the consideration paid for the security, together with interest at six percent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security. . . ." Id.)
108. The two states in the Eighth Circuit not adopting the Uniform Securities Act are North Dakota and South Dakota. However, the liability provisions in their respective states are substantially similar to the language contained in the Uniform Act. The North Dakota statute, N.D. CENT. CODE § 10-04-17 (1983), provides for recovery of "the full amount paid by [the] purchaser, together with all taxable court costs, interests . . . and reasonable attorney's fees, less the amount of any income received on the securities . . . ." (emphasis added); the South Dakota statute, S.D. CODIFIED LAWS ANN. § 47-31-133(1) (Rev. 1983) provides for recovery of "the full amount paid, together with interest from the date of payment for the securities sold . . . less any income or other amount received by such purchaser on such securities. . . ." (emphasis added).
the Harvard Law School, contains both official comments and unofficial section-by-section comments by Professor Loss.\textsuperscript{110} The official comments to section 410(a)(2) state that "[t]his clause is almost identical with § 12(2) of the Securities Act of 1933. . . .\textsuperscript{111} The unofficial comment by Professor Loss regarding section 410(a)(2) states that "[t]he resemblance [of section 410(a)(2)] to section 12(2) of the Securities Act of 1933 . . . will once more make for an interchangeability of federal and state judicial precedence in this very important area."\textsuperscript{112} The clear intent of the drafters of section 410(a)(2) of the Uniform Act was to have it apply "interchangeably" with federal and state judicial precedent.\textsuperscript{113} This is apparently a factor not considered by the Eighth Circuit when it refused to apply the federal precedent established by \textit{Austin} when construing a virtually identical state statute in \textit{Hayden}.\textsuperscript{114}

Since all states in the Eighth Circuit have statutory language similar to that involved in \textit{Hayden}, the Eighth Circuit should, in order to reduce confusion and increase consistency in this area, look to both state and federal judicial precedent when construing virtually identical state and federal statutes.\textsuperscript{115} Interestingly, the Eighth Circuit in \textit{Hayden} did look to federal precedent when faced with virtually identical state and federal statutes. It did so, however, only when discussing the definition of securities and the defense of waiver\textsuperscript{116} but not when considering similar state and federal statutes containing the language "less income received."\textsuperscript{117} The court's statement that it was reaffirming its position in \textit{Austin}, therefore, is not entirely true. It is clear that the court will only apply \textit{Austin} when the cause of action is based on federal securities laws.\textsuperscript{118} If the cause of action arises under state law, however, the court apparently will

\textsuperscript{110} L. Loss, \textbf{Commentary on the Uniform Securities Act} at V (1976).

\textsuperscript{111} The Official Comment for § 41(a)(2) states:

This clause is almost identical with § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77L(2), which was also borrowed almost verbatim in § 451.116 of the Michigan statute and § 13.1-522(a)(2) of the new Virginia act. For a comparison of § 12(2) of the federal statute with equitable rescission, from which it was adopted, see Loss, \textit{Securities Regulation} (1951 with 1955 Supp.), pp. 997-1001, 1003-11. Section 410(a)(2), like § 101, the general fraud provision, applies regardless of whether the security is registered, exempted, or sold in violation of the registration requirements."

\textsuperscript{112} L. Loss, supra note 110, at 147.

\textsuperscript{113} Id.

\textsuperscript{114} \textit{Austin} construed both § 12(2) of the Securities Act of 1933 and \textit{Minn. Stat. Ann.} § 80A.23, and determined that, in both cases, tax benefits received by the plaintiff should be considered in determining damages. \textit{See Austin}, 675 F.2d at 181.

\textsuperscript{115} \textit{See text at note 112 supra.}

\textsuperscript{116} \textit{See Hayden}, 742 F.2d 428, 430-31 (discussing the definition of "security" and the defense of waiver).

\textsuperscript{117} \textit{Hayden}, 742 F.2d at 439-41.

\textsuperscript{118} Id. at 440-41.
apply whatever precedent exists under the laws of that state.\textsuperscript{119}

As Chief Judge Lay stated in his concurring opinion, the majority in \textit{Hayden} has created a "meaningless distinction" between state and federal law.\textsuperscript{120} Thus, the \textit{Hayden} court inappropriately failed to follow the \textit{Austin} decision, and the plaintiffs' recovery should have been reduced by the tax benefits received from their investment.\textsuperscript{121}

It now appears that plaintiffs in the Eighth Circuit suing under the federal securities laws will have the amount of their recovery reduced by the tax benefits received from the investment.\textsuperscript{122} Subsequent to \textit{Austin}, the circuits have split on the issue of whether tax benefits constitute income in a tax shelter case.\textsuperscript{123} Additionally, the IRS and the SEC have taken the position that tax benefits should not be considered when awarding plaintiffs restitutional recovery.\textsuperscript{124} Subsequent to the \textit{Hayden} decision, the Second Circuit Court of Appeals decided \textit{Salcer v. Envicon Equities Corp.}.\textsuperscript{125} In \textit{Salcer}, the plaintiff investors sued the defendant promoters for failing to disclose material information relating to a real estate tax shelter.\textsuperscript{126} Despite arguments to the contrary by the SEC and the IRS,\textsuperscript{127} the Second Circuit Court of Appeals held that "[t]o the extent that plaintiffs invested in a tax shelter, all benefits they received from their investment, including tax benefits, would have to be deduced in calculating the rescissionary damages, if any, to which they would be entitled."\textsuperscript{128} This case is important because it reveals the disparate positions taken by the IRS, the SEC, and the Second Circuit.

\textbf{IRS Position}

In \textit{Salcer}, the district court for the southern district of New York held that

\begin{itemize}
  \item \textit{Id. at} 441.
  \item \textit{Id. at} 442.
  \item \textit{Id. at} 935.
\end{itemize}
York, consistent with its earlier position in *Freschi*, refuted the plaintiffs' award by the amount of tax benefits received. On appeal, the IRS supported the district court's decision, arguing that, from an overall tax policy standpoint, the district court had reached a better result.

The IRS posited that defendants in securities fraud cases should not be allowed a credit for the tax benefits previously claimed by the plaintiffs because "there is no reason to believe that the plaintiffs will be able to keep the full measure of these benefits or, indeed, to keep any of the benefits at all." For support, the IRS relied on its authority to challenge original deductions under certain circumstances and its ability to cancel tax benefits in whole or in part. The IRS urged the court to reject the *Austin* approach of permitting the jury to "second-guess whether and to what extent the IRS may successfully disallow the tax shelter deductions." The IRS took the position that a jury should not be allowed to speculate whether the IRS would act and whether it would be successful.

In addition to arguing that a jury should not be allowed to speculate as to possible IRS action, the IRS contended that in either a rescission action or a rescissionary damages action, the tax benefits derived by the plaintiffs should not be considered. In a rescission action, it was argued, the tax benefit rule would apply to force plaintiffs to report as ordinary income the recovery of their investment. Thus, the tax benefits received by plaintiffs should not be considered in computing damages because most of the tax benefits would be recaptured.

In a rescissionary damages action, the IRS stated that if a plaintiff had his rescissionary damages reduced by tax benefits received,

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129. See notes 48-51 and accompanying text supra.
130. IRS Amicus Curiae Brief at 3, *Salcer*. The IRS argued as precedent the Ninth Circuit case of *Burgess v. Premier Corp.*, 727 F.2d 826, 838 (9th Cir. 1984). In *Burgess*, the court "decline[d] to make the government the banker for the fraudulent tax shelter activity." 727 F.2d at 838. For an explanation of the court's language, see note 45 supra.
131. IRS Amicus Curiae Brief at 5, *Salcer*.
132. *Id.*
133. *Id.* at 6.
134. *Id.* at 6.
135. *Id.*. *But cf. Austin*, 675 F.2d at 183 (stating that "the jury is entitled to determine whether and to what extent there would be a disallowed of deductions"); *Hayden*, 742 F.2d at 440 (a jury may consider past tax benefits and future tax consequences in considering damages). The IRS also argued that the decision of the jury would not be binding on the IRS and amounted only to speculation on the part of the jury. IRS Amicus Curiae Brief at 6, *Salcer*.
136. IRS Amicus Curiae Brief at 6-7, *Salcer*.
137. *Id.* at 6.
138. *Id.*
the defendant would be relieved of his fraud liability at the expense of the government.\textsuperscript{139} The government would be precluded from using the tax benefit rule to recover from the plaintiff any offsetting tax liability.\textsuperscript{140} Finally, the IRS made a collateral source argument by stating that the tax benefits came from Congress' determination that certain investments should receive favorable tax treatment and not from any action on the part of the defendant promoter.\textsuperscript{141}

\textit{SEC Position}

The SEC argued a position similar to that taken by the IRS.\textsuperscript{142} The SEC argued that under the collateral source doctrine, it was the government and not the defendant who conferred the tax benefits upon the plaintiff.\textsuperscript{143} Thus, allowing defendants to reduce their damages by amounts the plaintiff received from independent collateral sources, in this case the government, would bestow on defendant promoters a benefit earmarked for the plaintiff.\textsuperscript{144} The SEC further argued—consistent with Hayden—that the court should consider the "entire" tax consequences to the plaintiff, past and future.\textsuperscript{145} The SEC added, however, that "any judgment would itself result in tax consequences which would largely, if not totally, eliminate the prior tax savings."\textsuperscript{146} Therefore, in the opinion of the SEC, a rescissionary recovery would "wash out" the prior tax savings, and, accordingly, a court should not offset the award by the tax savings.\textsuperscript{147}

Finally, the SEC contended that the plaintiff should not be viewed as receiving a windfall as a result of the government's inability to recoup fully the plaintiff's prior tax savings because merely restoring the purchase price to plaintiffs would not, in the SEC's
Second Circuit's Position

The Second Circuit's decision in Salcer appears to be consistent with the Eighth Circuit's opinion in Hayden. Like the Hayden court, the Second Circuit considered tax benefits received by the plaintiffs as relevant in determining damages for several reasons.

First, the Second Circuit dispensed with the collateral source argument made by the IRS, the SEC, and the plaintiffs, stating that "the tax benefits, although paid by the government, emanate directly from the tax shelter sought by the plaintiffs and provided by the defendants, without which the plaintiffs could not have realized any tax benefits." Second, the court rejected the argument that the government would be "the banker for the fraudulent tax shelter activity" when it declared that the government, by offering tax benefits, fulfilled the underlying tax policy of encouraging residential development. Thus, the court found that the government was "'banking' precisely what it had agreed to 'bank.'"

Third, the court rejected the argument made by the IRS that it may challenge the original deductions, and, therefore, the deductions previously taken may be purely illusory. The court indicated that there must be a showing of facts in each specific case which would justify the IRS's contention that it may challenge the original deductions. Without such a showing, the court will not ignore the tax benefits, nor will it assume that the IRS will act to disallow the pre-
vious deductions.\textsuperscript{155}

Fourth, the court distinguished between actions where the tax benefit rule would and would not apply.\textsuperscript{156} It stated that in a case of actual rescission, the tax benefit rule might apply because such recovery would be inconsistent with the plaintiffs' original claim as owners.\textsuperscript{157} However, the court indicated that the same result would not be reached in rescissionary damages action because, although the remedy would be labeled rescissionary damages, it would not be inconsistent with the plaintiffs' prior tax position.\textsuperscript{158} The court reasoned that rescissionary damages would not be a return of the plaintiffs to the same position they would have occupied had they never made the investment but merely an award of damages after crediting them with their tax benefits.\textsuperscript{159}

Finally, the Second Circuit held that since investments of this sort are admittedly entered into for the dual purpose of tax benefits on the one hand and income or appreciation on the other, an allocation of the purchase price between the tax and appreciation components would have to be made.\textsuperscript{160} "To the extent that plaintiffs invested in a tax shelter," the Second Circuit requires that "all benefits they received from their investment, including tax benefits, . . . be deducted in calculating the rescissionary damages, if any, to which they would be entitled."\textsuperscript{161}

**Implications for Practitioners in the Eighth Circuit**

In light of Hayden, it is important for practitioners to realize that the Eighth Circuit apparently will allow different interpretations of the word "income" under state and federal securities laws.\textsuperscript{162} Since all states in the Eighth Circuit have language in their Blue Sky acts similar to that construed in Hayden,\textsuperscript{163} it would behoove a plaintiff in a tax shelter case to base its claim on state securities laws and

\textsuperscript{155} Salcer, 744 F.2d at 942. See also note 44 and accompanying text supra.
\textsuperscript{156} Id. at 943.
\textsuperscript{157} The Salcer court reached a different outcome than Burgess because Salcer dealt with a case of rescissionary and not actual damages. See Burgess, 727 F.2d at 826. Actual rescission requires an exchange of the property that was the subject matter of the transaction, whereas rescissionary damages are allowed when actual rescission is impossible. The basis for rescissionary damages is the unjust enrichment the plaintiff bestows on the defendant. See A. Jacob, Litigation and Practice Under Rule 10b-5 § 280.03(c)(vi)(A) (1984).
\textsuperscript{158} Salcer, 744 F.2d at 943.
\textsuperscript{159} Id.
\textsuperscript{160} Id. at 940. The court stated that the allocation would be based on a factual determination made in each case. Id.
\textsuperscript{161} Id. at 940-41.
\textsuperscript{162} See text at notes 97-98 supra.
\textsuperscript{163} See notes 106-108 and accompanying text supra.
not on federal securities laws. In an action brought under the federal securities laws, the Eighth Circuit has stated that it will reduce a plaintiff's damages by the tax benefits received. On the other hand, in an action based on state securities laws, the Eighth Circuit has indicated a willingness to permit each state to interpret its own laws. Accordingly, in an action based on state securities laws, there is at least a chance that plaintiffs will not have their damages reduced by tax benefits received. Chief Judge Lay, however, argued that Hayden created a meaningless distinction between two "virtually identical" statutes. His assessment of the interplay between the state and federal statutes appears to be a logical conclusion and remains consistent with the overall goal of coordinating interpretations of related state and federal securities laws.

Practitioners in the Eighth Circuit should also be aware of the distinction between an actual rescission case and a rescissionary damages case. In an actual rescission case, the tax benefit rule will apply, while in a rescissionary damages action, it will not. In either case, the Eighth Circuit has indicated that it will not assume that the IRS will tax a plaintiff's recovery. It will allow experts to produce evidence of both past tax benefits and future tax consequences. Additionally, the court will permit evidence as to the possibility that the government will seek its share of a judicial recovery.

Another important argument available to both plaintiffs and defendants is the "collateral source" doctrine. The collateral source doctrine prevents a wrongdoer from reducing its damages by payments that are made to the plaintiff from independent collateral

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164. See notes 97-99 and accompanying text supra.
165. See notes 97-106 and accompanying text supra.
166. Hayden, 742 F.2d at 441-42.
167. See, e.g., MINN. STAT. ANN. § 80A.31 (West Supp. 1984). See also notes 97-121 and accompanying text supra.
168. Salcer, 744 F.2d at 943.
169. Hayden, 742 F.2d at 440. Although the Eighth Circuit has not expressly discussed this distinction, it is safe to assume that the court would follow the approach taken by the Second Circuit. The court indicated that it will not assume that application of the tax benefit rule will automatically cancel out past deductions, nor will it assume that a successful plaintiff in a rescissionary damages action will have his deductions recaptured. Id. Accord Austin, 675 F.2d at 183; Salcer, 744 F.2d at 942; but cf. Chief Judge Lay's concurring opinion in Hayden wherein he assumes that the tax benefits received by a plaintiff in a rescissionary damages action "will be accounted for as recaptured depreciation under the Internal Revenue Code." He argued, however, that this accounting "is between the government and the taxpayer; the defendant should receive no gain from the possible tax consequences resulting from the plaintiff's recovery." Hayden, 742 F.2d at 441-42; accord Burgess, 722 F.2d at 838 (presuming the IRS will do its duty).
170. Hayden, 742 F.2d at 440.
171. Id.
Plaintiff/investors will want to argue that the doctrine should apply to prevent defendants from benefiting from the collateral source of the plaintiff's tax benefits. Specifically, plaintiffs will take the position that "the true source of the tax savings was the income generated through the independent efforts of the plaintiffs, which gave rise to their ability to take advantage of the tax deductions generated by the business venture." Further, plaintiffs will contend that the tax benefits were conferred by the government and not by the defendants, the position espoused by Chief Judge Lay in his concurring opinion in Hayden.

Defendants, meanwhile, will take the position that "the tax benefits, although paid by the government, emanate directly from the tax shelter sought by the plaintiffs and provided by the defendants, without which the plaintiffs could not have realized any tax benefits." This is the position apparently taken by the majority in Hayden.

It appears that the most logical approach in a tax shelter case is to consider the tax benefits received by the plaintiff/investor in determining damages. Therefore, application of the collateral source rule should not be permitted. The realities of the situation suggest that without the defendant/promotor's creating such an investment, there would be no tax deductions available to the plaintiff. As the Second Circuit pointed out in Salcer, "[t]he fact that the tax benefits were paid by the government rather than by the defendants does not lessen the defendant's role in securing them." It is the defendant/wrongdoer who has provided the benefit to the plaintiff/investor, not an independent collateral source. Thus, the doctrine should not apply, and the defendant should be allowed to reduce the plaintiff's damages by the amount of tax benefits received by the plaintiff and provided by the defendant.

CONCLUSION

When the Hayden court indicated that it was reaffirming its earlier decision in Austin, the court did not tell the whole story. Although indicating that tax benefits may be relevant in determining

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173. See notes 141-44 and accompanying text supra.
174. SEC Amicus Curiae Brief at 11-12, Salcer.
175. Id.
176. Hayden, 742 F.2d at 441-42.
177. Salcer, 744 F.2d at 941-42.
178. Hayden, 742 F.2d at 441.
179. See Salcer, 744 F.2d at 941-42 (discussing collateral source doctrine).
180. Id. at 942.
damages in tax shelter cases, the court in Hayden apparently limited its holding to actions based on federal securities laws. The Eighth Circuit will allow differing interpretations of state and federal securities statutes even though the statutes are virtually identical. Thus, a plaintiff in a tax shelter case will generally want to base its action on state securities laws rather than federal securities laws because, under state law, there is at least a chance that any damages will not be offset by the tax benefits received from the investment. It is unfortunate that the Eighth Circuit has created a distinction between two similar statutes intended to be applied consistently. However, since Hayden indicates that the court will continue to create such a distinction, plaintiffs should take advantage of the opportunity and maximize their potential recoveries by basing their actions on state securities laws.

Though the Eighth Circuit has shown a willingness to consider tax benefits in offsetting a plaintiff's damages, other circuits have split on the issue. The Ninth Circuit has determined not to consider tax benefits while the Second Circuit has taken a contrary position. Further, the IRS and the SEC have supported the Ninth Circuit's decision not to consider tax benefits. Inevitably, the Supreme Court will have to resolve the split among the circuits.

The approach adopted in this Note is to permit tax benefits to be considered when determining damages in tax shelter cases. To do otherwise would be to ignore investment realities. As was stated in Brgen v. Scott,181 “[r]equiring the jury or this court to try this case without reference to the tax consequences of the transaction would be requiring the jury and the court to live in an artificial ‘never-never land’ . . . and is tanamount to requiring this court and the jury to try this case blindfolded.”

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