

COMMENTS CONCERNING TEMPORARY AND PROPOSED REGULATIONS
UNDER SECTIONS 6011, 6111, AND 6112
OF THE INTERNAL REVENUE CODE OF 1986
T.D. 8875, 8876, AND 8877

Executive Summary

These comments are presented on behalf of the American Bar Association Section of Taxation. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.

The Section of Taxation commends the Treasury Department and the Internal Revenue Service (the “IRS”) for their promulgation of the temporary regulations governing corporate tax shelter return disclosure, corporate tax shelter registration, and investor list maintenance and believes that the regulations represent a significant contribution to the ongoing process of crafting appropriate rules to halt abusive corporate tax shelters. We appreciate the opportunity to comment on the substance of the regulations and the procedures that the IRS should use to administer and enforce the registration and investor list maintenance regulations. This summary lists the main points included in our comment letter.

I. Corporate Tax Shelter Return Disclosure.

- We encourage the IRS to publish an annual revenue procedure identifying transactions for which disclosure is not required.
- We recommend that the “no reasonable basis for denial” exception be amended to provide instead that disclosure is not required if the IRS lacks substantial authority to support a challenge to the taxpayer’s claimed treatment of the transaction.
- We recommend that the size thresholds for listed transactions in the projected tax effect test be either eliminated or greatly reduced.
- We believe that the IRS should consider imposing a monetary penalty on taxpayers for failure to make a required disclosure.

II. Corporate Tax Shelter Registration.

- We encourage the IRS to amend the regulations to provide that, when no legally binding agreement or understanding between the promoter and the offerees exists and the promoter has no legally protectible interest in the transactional idea pursuant to either contract or intellectual property law, tax shelter registration is not required, even if the promotional materials for the transaction state that the transaction is “proprietary” or “exclusive” to the tax shelter promoter.

- We suggest that the IRS eliminate the economic substance test and replace it with an objective six-factor test similar to the six-factor test in Section 1.6011-4T(b)(3)(i) of the disclosure regulations. We recommend that the “ordinary course of business” exception apply to such new test.
- We believe that the “other tax-structured transactions” standard set forth in Section 301.6111-2T(b)(4) of the regulations is too broad and we recommend that such section instead apply to transactions “the principal purpose of which is tax avoidance.”
- We recommend that the “no reasonable basis for denial” exception be amended to provide an exception from disclosure if the IRS lacks substantial authority to support a challenge to the taxpayer’s claimed treatment of the transaction.

III. Investor List Maintenance.

- We recommend that the IRS amend the regulations to limit the scope of the investor list requirement to transactions that are required to be either registered pursuant to T.D. 8876 or disclosed pursuant to T.D. 8877.
- We believe that the persons required to maintain investor lists under Code section 6112 should be defined in a manner consistent with the definition of the term “tax shelter promoter” under Section 301.6111-2T(f) of the registration regulations.
- We recommend that the IRS amend the regulations to require tax shelter promoters to file schedules on an annual basis that list (i) all of the transactions for which they maintained investor lists for the preceding calendar year and (ii) all of the transactions for which they would have maintained investor lists for the preceding calendar year but for the applicable exceptions from the investor list requirement.

IV. Administration and Enforcement.

- We recommend that the IRS develop an audit program for tax shelter promoters to audit their compliance with the registration and investor list regulations.
- In the event that the IRS discovers a corporate tax shelter in the marketplace or such a shelter otherwise comes to the attention of the IRS, we suggest that the IRS adopt procedures for immediately obtaining information from tax shelter promoters.

I. Corporate Tax Shelter Return Disclosure.

A. In General. T.D. 8877 sets forth temporary regulations requiring corporations to attach disclosure statements to their income tax returns describing their tax shelters. Temp. Reg. § 1.6011-4T. We commend the Treasury Department and the IRS for their promulgation of these additional reporting requirements. As we have previously stated, we believe that the IRS presently has the authority to require such disclosures as a part of a corporation's return-filing requirement. We also believe that the temporary regulations appropriately use return disclosure as a means of providing more, and more timely, information regarding types of transactions that would likely be of interest to the IRS on audit.

With respect to the definition of "reportable transaction," which is at the core of the disclosure requirement, the temporary regulations attempt to balance the needs of the IRS for better information on certain types of transactions with the burden on taxpayers of complying with an intrusive and burdensome regime of reporting and document retention. Id. § 1.6011-4T(b)(3)(i). While we think that, on balance, a relatively broad definition of "reportable transaction" is warranted initially, we also think that reporting and document-retention burdens should receive ongoing attention. Accordingly, we encourage the IRS to track the transactions that are disclosed under the temporary regulations for the purpose of identifying those for which such extraordinary disclosure is not warranted and to publish an annual revenue procedure identifying transactions for which disclosure is not required. Id. § 1.6011-4T(b)(3)(ii)(D).

The adoption of a broad definition of "reportable transactions" will place more emphasis on the exceptions to disclosure. Although we commend the IRS for attempting to draft exceptions that reflect commercial reality, as drafted, the exceptions do not set forth standards that are sufficiently clear so that taxpayers can determine whether a transaction must be disclosed. Accordingly, as stated in Part I.D below, we recommend that the exception for transactions with respect to which the taxpayer determines that there is "no reasonable basis for denial" of the tax benefits be amended to provide instead that disclosure is not required if the IRS lacks substantial authority to support a challenge to the taxpayer's claimed treatment of the transaction. Such an objective exception not only would provide taxpayers with a workable standard with respect to which there are well-developed rules and regulations but also would make it easier for the IRS to enforce the disclosure regulations and any penalties imposed for noncompliance with the regulations. If the IRS declines to adopt the "no substantial authority" exception, we recommend, in the alternative, that the "no reasonable basis for denial" exception be amended to provide that disclosure is not required if the IRS would have "no realistic possibility of success" on the merits against the taxpayer.

B. Substantially Similar Transactions. The regulations include within the term "reportable transaction," "any series of substantially similar transactions entered into in the same taxable year." Id. § 1.6011-4T(b)(1). We are concerned that this terminology lacks definition and may permit overly broad interpretation. The "substantially similar" concept is not necessary in the case of listed transactions because the IRS can address the scope of a listed transaction at the time that such transaction is identified. Id. § 1.6011-4T(b)(2). As for

“other reportable transactions” described in Section 1.6011-4T(b)(3) of the regulations, presumably any transaction that meets the size threshold for a reportable transaction (i.e., more than a \$5 million reduction in tax liability in one year or more than \$10 million in multiple years) would be independently reportable. Because an undefined concept of “similarity” is too vague and subjective for this purpose, we believe that the aggregation rule only should apply to transactions that are “identical or substantially identical.” In the alternative, we encourage the IRS to delineate the factual or legal nexus that justifies aggregating independent transactions. While we understand the IRS’s desire to prevent taxpayers from avoiding the tax return disclosure requirement by entering into multiple transactions, it should be possible to develop a more targeted aggregation rule based on criteria that permit greater certainty for corporate taxpayers.

We also believe that the one-year rule for aggregating transactions is arbitrary. This rule permits taxpayers to avoid the disclosure rules by waiting until after the end of a taxable year to engage in a transaction. The IRS may want to consider revising the rule to aggregate transactions that have occurred or that are expected to occur as of the applicable tax return filing date. In addition, we recommend that the IRS clarify in the regulations that a series of transactions that are aggregated under Section 1.6011-4T(b)(1) will be treated as a single transaction for all purposes under the tax return disclosure regulations, including the rule that a separate disclosure statement is required for each separate transaction.

C. Definition of “Other Reportable Transactions.” We applaud the IRS’s creation of an objective test in Section 1.6011-4T(b)(3) of the regulations to determine which transactions other than listed transactions must be disclosed. However, although we believe that factors (A), (B), and (C) constitute appropriate identifying factors for transactions likely to be of interest to the IRS, we note that the existence of such factors may be avoided fairly easily. While factors (D), (E), and (F) are less easily avoided and do tend to be present in transactions of interest to the IRS, they also are present in many transactions that are likely to be of little interest to the IRS. Accordingly, the current definition of “other reportable transactions” is likely to generate disclosure of a large volume of transactions that are not corporate tax shelters.

In this regard, we respectfully urge the IRS to consider carefully the appropriateness of factor (D). Every corporation has significant book/tax timing differences, most of which do not have any relationship to corporate tax shelters of the type that are the target of the disclosure rules. Furthermore, most of such book/tax differences are eliminated over time. Accordingly, we recommend that factor (D) be amended to apply only to permanent book/tax differences. In that case, we believe that a significant amount of unnecessary reporting could be avoided.

We also respectfully urge the IRS to consider carefully the appropriateness of factor (F). Many transactions will result in U.S. tax consequences that differ from the foreign tax consequences of the transaction. Accordingly, we recommend that factor (F) be amended to apply only to transactions with respect to which the foreign party was included in order to achieve a U.S. tax result that otherwise would not have been available. Otherwise, many

multinational corporations will be required to disclose a great deal of transactions that do not have any relationship to corporate tax shelters of the type that are the target of the disclosure rules. Again, we believe that this amendment would enable taxpayers and the IRS to avoid a significant amount of unnecessary reporting.

D. Exceptions to Disclosure. The IRS should monitor whether the regulations generate a large volume of disclosure statements that are burdensome to taxpayers but of little interest to the IRS. Specifically, the IRS should carefully consider the scope of the exceptions from the disclosure requirement set forth in Section 1.6011-4T(b)(3)(ii) of the regulations. The most important of those exceptions is that in clause (D), which contemplates that the IRS will publish guidance excepting transactions from disclosure. We encourage the IRS to be aggressive and prompt in publishing such guidance.

We also believe that the exception set forth in clause (C), which excludes transactions from disclosure when the taxpayer reasonably determines that there is “no reasonable basis” for denial of the related tax benefits, could, and should, play a much more significant role in the regulations. We encourage the IRS to reformulate this exception to cover any transaction with respect to which an IRS disallowance of the tax benefits would not be supported by substantial authority. Establishing such a threshold for the exception and making the standard an objective one should eliminate disclosure of many transactions in which the IRS should have little interest and should assist the IRS in enforcing the regulations and any penalties imposed for noncompliance with the regulations. We also believe that the elimination of the taxpayer’s “reasonable determination” will result in more objective results. If the IRS declines to adopt the “no substantial authority” exception, we recommend, in the alternative, that the “no reasonable basis for denial” exception be amended to provide that disclosure is not required if the IRS would have “no realistic possibility of success” on the merits against the taxpayer. We believe that the “no realistic possibility of success” standard also is a more objective standard that should assist the IRS in enforcing the regulations and any penalties imposed for noncompliance with the regulations. Moreover, consistent with our prior testimony to legislative committees regarding tax penalties, we believe that a statement that the IRS has “no reasonable basis for denial” of a tax treatment means that the IRS has “no realistic possibility of success” on the merits.

E. Projected Tax Effect Threshold. We agree that a fairly high dollar threshold should be established for reportable transactions that are not “listed transactions,” and we believe that the \$5 million and \$10 million thresholds are reasonable. *Id.* § 1.6011-4(b)(4)(i). However, we do not agree that a dollar threshold should be established for transactions that are identified in IRS guidance as “listed transactions,” because the IRS has identified such transactions as worthy of disclosure and taxpayers can avoid the disclosure requirement by entering into listed transactions of a smaller but still substantial size. We believe that disclosure of smaller listed transactions is desirable, particularly for smaller corporate taxpayers. Accordingly, we recommend that the size thresholds for listed transactions be either eliminated or greatly reduced (e.g., to \$100,000 and \$200,000 rather than \$1 million and \$2 million).

F. Computation of Projected Tax Effect. While we believe that a projected tax effect threshold is relatively unimportant for listed transactions, we believe that a clear and fairly substantial projected tax effect threshold is important for non-listed transactions. However, we believe that the computation of the projected tax effect set forth in Section 1.6011-4T(b)(4) of the regulations is confusing and ambiguous. That section provides that “a transaction will be treated as reducing a taxpayer’s Federal income tax liability for a taxable year if, and to the extent that, disallowance of the tax treatment claimed . . . would result in an increase in the taxpayer’s Federal income tax liability for that year.” As written, the projected tax effect test is a proper standard for a transaction with respect to which the IRS potentially could disallow all of the tax benefits, such as the transaction in ACM Partnership in which a completely artificial loss was generated.¹ However, we believe that a different standard should apply both in the case of a transaction with respect to which the IRS potentially could disallow only a portion of the tax benefits and in a situation where the IRS disagrees with the timing of, but not the taxpayer’s ability to claim, the tax benefits from a transaction (e.g., if the IRS determines that a taxpayer should have recognized a loss in a later year than the year in which the taxpayer claimed the loss). In the case of a possible partial disallowance of tax benefits, we recommend that the reduction in the taxpayer’s tax liability for purposes of the projected tax effect test be determined solely by reference to such partial disallowance. In the case of a timing difference, we recommend that the IRS set forth a standard that determines the projected tax effect of the transaction based on the present value of the accelerated tax benefits or deferred income using a discount rate equal to a multiple of the applicable federal rate.

G. Examples. We recommend that the IRS amend the regulations to provide specific examples of transactions that qualify for the exceptions in Section 1.6011-4T(b)(3)(ii) (B) and (C) because the related tax benefits are expressly authorized by the Code. The examples could include transactions that generate tax benefits listed in Section 1.6662-4(g)(2)(ii) of the Treasury regulations, tax credits under Code sections 29 and 42, the failure to make a Code section 754 election, and other transactions expressly permitted by the partnership anti-abuse regulations in Treasury regulations section 1.701-2. On the other hand, if the IRS adopts our recommendation that exception (C) should apply when there is no substantial authority to support an IRS challenge to the taxpayer’s position, examples would not be needed for that exception because there is ample precedent regarding the substantial authority standard.

H. Failure to Disclose. Although there are penalties for failing to register a tax shelter (Code section 6707) and to maintain an investor list (Code section 6708), there is no specific penalty for failing to disclose a reportable transaction. The preamble to the temporary regulations, however, indicates that failure to disclose will affect the determination of whether a taxpayer has acted in good faith for purposes of the “reasonable cause” exception of Code section 6664(c). We recommend that this point be expressly included in

¹ See ACM Partnership v. Comm’r, T.C. Memo. 1997-115 (1997), aff’d in part, rev’d in part, 98-2 U.S.T.C. ¶ 50,790 (3rd Cir. 1998).

both the Section 1.6011-4T regulations and the regulations under Code section 6664(c). The amendment to the definition of “reasonable cause” should note that “good faith” will be affected by the quality and completeness of the disclosure as well as the existence or absence of disclosure.

In this regard, consistent with our prior testimony to legislative committees, we believe that the IRS should consider imposing a monetary penalty on taxpayers for failure to make a required disclosure. If the IRS believes that it lacks the statutory authority to impose such a monetary penalty, we would be pleased to work with the IRS to obtain legislation specifically authorizing the imposition of such a penalty.

I. Other Comments. For the reasons set forth in the Section of Taxation’s prior comments, we continue to believe that a senior corporate officer with knowledge of the facts should be required to sign the disclosure form under penalties of perjury.

Section 1.6011-4T(c)(1)(iii) and (iv) of the Regulations should refer to “Federal income tax benefits,” rather than “tax benefits.”

We recommend that Section 1.6011-4T(c)(1)(vi) of the regulations be coordinated with the definition of tax shelter promoter in Section 301.6111-2T(f) of the registration regulations, so that the persons required to be identified on disclosure statements are the persons described as tax shelter organizers in Code section 6111(e)(1) and Q&A-26 through 33 of Section 301.6111-1T of the investor list regulations. We recommend that persons described in Q&A-30 and Q&A-33 be excluded both from being identified on disclosure statements and from the definition of tax shelter promoter in Section 301.6111-2T(f) of the registration regulations.

Section 1.6011-4T(d) provides that a transaction that becomes a reportable transaction after the filing of the taxpayer’s tax return will be subject to the disclosure requirement in the return next filed. It is not clear whether this requirement is limited to transactions having tax consequences in the taxable period for which the second return is filed. We recommend that the IRS amend the regulations to provide such a limit.

Under Section 1.6011-4T(a), a taxpayer who does not directly participate in a transaction is required to file a disclosure statement if its federal income tax liability is affected by the transaction. We believe that this provision is overbroad and recommend that the disclosure requirement be limited to situations in which either the taxpayer controls the entity engaging in the transaction (by direct or indirect ownership of more than 50% of such entity) or the entity was formed to engage in the particular transaction. Otherwise, the taxpayer may not have access to the information required by the disclosure statement or even have knowledge of the transaction.

II. Corporate Tax Shelter Registration.

A. Conditions of Confidentiality. Registration of corporate tax shelters under Code section 6111(d) is limited to transactions that are offered to any potential participant under “conditions of confidentiality.” I.R.C. § 6111(d)(1)(B). As defined by the facts-and-circumstances test in the temporary regulations, an offer is considered made under conditions of confidentiality “if an offeree’s disclosure of the *structure or tax aspects* of the transaction is *limited in any way* by an express or implied understanding or agreement with or for the benefit of any tax shelter promoter . . . whether or not such understanding or agreement is legally binding.” Temp. Reg. § 301.6111-2T(c)(1). Furthermore, conditions of confidentiality will be deemed to exist in the absence of any such understanding or agreement “if any tax shelter promoter knows or has reason to know that the offeree’s use or disclosure of information relating to the structure or tax aspects of the transaction is limited for the benefit of any person other than the offeree in any other manner, such as where the transaction is claimed to be *proprietary or exclusive to the tax shelter promoter or any party other than the offeree.*” *Id.* The temporary regulations also include a presumption that an offer is not made under conditions of confidentiality if the tax shelter promoter provides express written authorization to each offeree permitting the offeree (and each employee, representative, or other agent of such offeree) to disclose the structure and tax aspects of the transaction to any and all persons, without limitation of any kind on such disclosure.” *Id.* § 301.6111-2T(c)(3).

We understand and applaud the IRS’s desire to obtain registrations for as wide a range of transactions as possible. However, we suggest that the IRS carefully consider whether the definition of “conditions of confidentiality” is overbroad and will result in registration of transactions for which the regulations were not intended. The registration obligation in Code section 6111 potentially falls on a broad range of persons. See I.R.C. § 6111(e)(1). For this reason, an overly broad definition of conditions of confidentiality in the regulations would both impose burdens on persons not fairly within the scope of the statute and make it difficult for the IRS to identify the persons and transactions at which the requirement is properly directed. We encourage the IRS to amend the regulations to provide that, when no legally binding agreement or understanding between the promoter and the offerees exists and the promoter has no legally protectible interest in the transactional idea pursuant to either contract or intellectual property law, tax shelter registration is not required, even if the promotional materials for the transaction state that the transaction is “proprietary” or “exclusive” to the tax shelter promoter.

Tax opinion letters commonly include a caveat that the opinion letter may not be relied upon for any other transaction or by any other party. Similarly, valuation studies, software, and spreadsheets that may accompany tax-planning ideas have limitations or licenses. These limitations are intended to avoid legal privity with unintended third party beneficiaries. The tax opinion letter caveat and the valuation report caveat do not limit disclosure or use by the client of the tax structure or the tax aspects of a transaction, but they do preclude reliance on the opinion or valuation study by third parties or by the client for another transaction. Licenses of software and spreadsheet applications do not normally affect

the tax aspects of a transaction, but their terms are necessary to limit legal liability. Similarly, e-mails and faxes commonly include a confidentiality statement to protect the confidentiality of clients and customers, as well as, in some cases, to claim the attorney-client privilege or to comply with Code section 7216. We encourage clarification of the regulations to except such caveats and statements from characterization as “conditions of confidentiality.” On the other hand, we note that, in some specific instances, conditions of confidentiality could effectively be embedded in software such as that used in complex derivatives trading strategies that implement a tax strategy. Thus, we recognize that some fine distinctions remain to be made.

B. Transactions Lacking Economic Substance: Section (b)(3). In general, we believe that the definition of “transactions structured for the avoidance or evasion of federal income tax” is a reasonable exercise of regulatory discretion. However, we do have a few observations. First, consistent with our prior statements, we believe that the “economic substance” test of Section 301.6111-2T(b)(3) of the regulations (“Section (b)(3)”) is vague and does not provide an objective standard by which to calculate “reasonably expected pre-tax profit” or “expected net Federal tax savings” or to determine when the relationship between the two is “insubstantial.” Therefore, such test is likely to give rise to substantial uncertainty and generate registration of many transactions that have long been unchallenged by the IRS. We recommend that the economic substance test be eliminated.

Instead of attempting to create objective standards for the economic substance test, we suggest that the IRS replace such test with an objective six-factor test similar to the six-factor test that appears in Section 1.6011-4T(b)(3)(i) of the disclosure regulations. In addition, we recommend that the “ordinary course of business” exception in Section 1.6011-4T(b)(3)(ii) of the disclosure regulations that applies in connection with such six-factor test also apply under “new” Section (b)(3) of the registration regulations. We note that the “ordinary course of business” exception in the registration regulations currently only applies to “other tax-structured transactions” described in Section 301.6111-2T(b)(4) (“(b)(4) transactions”) and not to transactions that fail the economic substance test of Section (b)(3). We also suggest that the IRS amend the registration regulations to clarify that the ordinary course of business exception does not apply to listed transactions described in Section 301.6111-2T(b)(2).

If the IRS declines to replace the economic substance test with an objective six-factor test, we recommend that the IRS clarify the mechanics of Section (b)(3). In particular, the IRS should provide detailed guidance regarding the present value concept, how to compute “reasonably expected pre-tax profit” and “expected net Federal tax savings,” and the meaning of “insubstantial.” In this regard, we note that many common transactions (such as a “standard” leveraged lease) likely would fail any test that is purely mechanical and that relies solely upon a time-value-of-money calculation. Furthermore, the degree of leverage involved in a transaction frequently will affect the expected economic results of the transaction. Any specific guidance in this regard should permit transactions in which

leverage results in favorable tax consequences as well as higher risks to the taxpayer.²

In addition, we recommend extending the ordinary course of business exception that currently only applies to (b)(4) transactions to apply to transactions described in Section (b)(3) (transactions lacking economic substance). While we recognize that the articulation of the economic substance test in Section (b)(3) has some support in case law, the present value approach used in the regulations has only been introduced recently in the economic substance test as articulated in the case law.³ As a result, we think it likely that many transactions not formerly thought of as transactions structured to avoid tax may be swept within the regulations, and we believe that the ordinary course of business exception should be available with respect to those transactions.

C. Other Tax-Structured Transactions: Section (b)(4). Although we agree that the registration regulations should contain a “catch-all” provision, we believe that the “other tax-structured transactions” standard set forth in Section 301.6111-2T(b)(4) of the regulations (“Section (b)(4)”) is too broad because it covers any transaction of which the tax benefits are “an important part of the intended results.” Because tax benefits are “an important part” of the intended results of many transactions, this standard will generate registration of many transactions that have long been unchallenged by the IRS. In order to narrow the scope of the catch-all provision, we recommend that Section (b)(4) instead apply to transactions “the principal purpose of which is tax avoidance.”

D. No Reasonable Basis for Denial Exception. The regulations presently exclude from registration transactions (other than listed transactions) with respect to which the promoter or other person “reasonably determines” that there is “no reasonable basis” for denial of the expected tax benefits. Temp. Reg. § 301.6111-2T(b)(5)(i). Although we agree that such transactions should not be required to be registered, the “reasonably determines” standard is subjective and would make enforcement of the regulations and the related penalties difficult. We recommend (as set forth in Part I.D above) that the IRS instead adopt an objective standard that excludes a transaction from registration if an IRS disallowance of the tax benefits would not be supported by substantial authority. This objective rule would eliminate the need for inquiries into the adequacy of legal opinions and better encourage registration in circumstances in which the state of legal authorities is uncertain. In the alternative, as described in Part I.D above, if the IRS declines to adopt the “no substantial authority” exception, we recommend that the “no reasonable basis for denial” exception be

² Leverage may have perverse effects, resulting in a greater present-value return to the taxpayer than a non-leveraged transaction. The impact of leverage is one of the reasons that the economic substance test set forth in the regulations does not operate to achieve its desired results.

³ See ACM Partnership v. Comm’r, T.C. Memo. 1997-115 (1997), aff’d in part, rev’d in part, 98-2 U.S.T.C. ¶ 50,790 (3rd Cir. 1998); ASA Investorings Partnership v. Comm’r, T.C. Memo. 1998-305 (1998), aff’d, 85 A.F.T.R.2d ¶ 2000-392, No. 98-1583 (D.C. Cir. 2000).

amended to provide that disclosure is not required if the IRS would have “no realistic possibility of success” on the merits against the taxpayer.

E. Examples. We encourage the addition in Section 301.6111-2T(b)(7) of examples of transactions that may be excluded from the registration requirement. Such examples might include transactions generating tax benefits listed in Section 1.6662-4(g)(2)(ii) of the regulations or Code section 29 or 42 tax credits, a failure to make a Code section 754 election, and other transactions expressly permitted in the Section 1.701-2 regulations.

F. Protective Registration. If a tax shelter promoter requests a ruling regarding whether a transaction is subject to the registration requirement, the promoter has the option of making a protective registration pending the outcome of the ruling request. *Id.* § 301.6111-2T(b)(6). The regulations do not address the effect on a participant in the transaction of such a protective registration. We recommend that the regulations clarify whether a registration number will be forthcoming, whether participants should report their participation in the transaction pending IRS action on the ruling request, and, if so, whether participants may indicate on their returns that the registration was made on a protective basis.

G. Aggregation of Fees and Transactions. The rule in Section 301.6111-2T(d) of the regulations governing the aggregation of fees for “substantially similar” transactions raises a variety of issues. Given the fact that the fee threshold for registration is \$100,000 and that this amount is well below the level of fees that a promoter ordinarily would receive from a single confidential corporate tax shelter, we believe that the aggregation rule is unnecessary if the transactions involve different taxpayers. We also believe that the aggregation rule should mirror the aggregation rule in Section 6011-4T(b)(1) of the disclosure regulations. Accordingly, we recommend that the IRS amend the last sentence of Section 301.6111-2T(d) to provide that aggregation only will occur if the transactions are “identical or substantially identical” and involve the same taxpayer.

Section 301.6111-2T(e)(2) of the regulations allows a tax shelter promoter to file a single Form 8264 for any aggregated tax shelter, provided that an amended Form 8264 is filed to reflect any “material changes,” including additional or revised written materials. Tax planning, like any other professional service, addresses the needs and circumstances of the client. One client’s circumstances and objectives often vary from those of another client and written materials generally are personalized to the client’s particular circumstances and needs. If the taxpayer is already “listed” and the transaction is substantially similar to a group of transactions that were aggregated into one registration, it seems unnecessary and unhelpful to require an amended filing. In order to avoid the amendment of Form 8264 (and to avoid unnecessary paperwork for the IRS) every time a corporation enters into a transaction covered by the regulations, we suggest that the regulations be amended to require amended registrations only when material changes to the structure of the transaction have been made. In addition, the IRS should consider deleting the amended filing provision, because a material structure change arguably would create a new tax shelter, thereby requiring a new (not an amended) registration.

H. Definition of Tax Shelter Promoter. The term “tax shelter organizer” was previously defined in Section 301.6111-1T, Q&A 26-33. The definition of “tax shelter promoter” set forth in Section 301.6111-2T(f) cross-references those rules. However, it is not completely clear that those rules are applied without modification. We recommend that the definition of “tax shelter promoter” in Section 301.6111-2T(f) be clarified to provide that the term does not include a person described in Q&A-30 or Q&A 33 of Section 301.6111-1T.

I. Filing Obligation. If all tax shelter promoters of a confidential corporate tax shelter are foreign persons and none of such promoters registers the transaction, any U.S. person who discusses participation must register the transaction or expressly reject participation within 90 days after beginning such discussions. I.R.C. § 6111(d)(3); Temp. Reg. § 301.6111-2T(g)(2). The 90-day period provided in the statute is a short period within which to evaluate the merits of a proposed tax planning idea to determine whether participation may be warranted. Accordingly, we recommend that the 90-day period be defined to exclude an unsolicited initial meeting and to commence no later than the prospective participant’s first written expression of interest in the idea or, if there is no such written expression, the prospective participant’s binding oral commitment to participate in the transaction. In addition, while we agree that a foreign person controlled by a U.S. offeree provides a basis for requiring registration, we see little real need for the added complexity of the modification of the control test of Code section 6038(e) in Section 301.6111-2T(g)(2)(v) of the regulations, particularly when the modifications made will require registration by a U.S. person on behalf of a foreign entity that it does not control. Accordingly, we recommend that the control test of Code section 6038(e) be applied unmodified.

We believe that the principal registration obligation should fall on the promoter rather than participants in the transaction. We also believe that the promoter’s filing obligation should be coextensive with IRS jurisdiction. Accordingly, when a foreign promoter is controlled by a U.S. parent company, we recommend that the U.S. parent company, rather than the prospective investor, have the filing responsibility. Similarly, if the foreign promoter has an office in the United States, we recommend that the foreign promoter have the filing obligation. Moreover, we recommend that the onus for communicating the status of registration of an investment should be on the promoter, rather than on a prospective investor whose participation in the transaction is uncertain. See Temp. Reg. § 301.6111-2T(g).

III. Investor List Maintenance.

A. Scope of List Requirement. Before the promulgation of T.D. 8875, the requirement that organizers and sellers of potentially abusive tax shelters maintain lists of investors applied to a relatively narrow set of transactions: (i) tax shelters that were required to be registered under Code section 6111 and (ii) “projected income investments” as defined by the temporary regulations under section 6111. Id. §§ 301.6111-1T, A-57A, 301.6112-1T, A-4 (prior to amendment by T.D. 8875). Although Code section 6112(b)(2) grants the IRS the authority to promulgate broader regulations, that authority had not been exercised prior to

T.D. 8875 (other than to include projected income investments, which are subject to special registration procedures under the section 6111 temporary regulations). See id. § 301.6112-1T, A-4 (prior to amendment by T.D. 8875).

T.D. 8875 expands the application of the investor list requirement to cover tax shelter transactions described in Code section 6111(d)(1)(A) (i.e., transactions a significant purpose of which is the avoidance or evasion of federal income tax) (“Section 6111(d)(1)(A) transactions”), whether or not any such transaction is offered to a direct or indirect corporate participant. Id. § 301.6112-1T, A-4. Unlike the related registration requirement of Code section 6111(d)(1), the new investor list requirement applies even if a transaction is not offered under conditions of confidentiality and the fees received by promoters total less than \$100,000. Id. Furthermore, a transaction is not required to be offered to a direct or indirect corporate participant in order to be subject to the investor list requirement, and the types of investors who must be included on a list under the new rules are not limited to corporations. Instead, it appears that all investors in a covered transaction, including both individuals and non-corporate entities, must be included on the list. Thus, the new list requirement appears to apply regardless of the size of the potential tax savings at issue, the size or contingent nature of the fee to be earned, the absence of any “conditions of confidentiality,” or the type of taxpayer involved. However, in certain cases, investors that do not meet certain fee and tax reduction thresholds are not required to be included on an investor list. Specifically, in the case of a tax shelter that (i) is not required to be registered under Code section 6111, (ii) is not a “listed transaction,” and (iii) is not a projected income investment as described in section 301.6111-1T A-57A, an investor need not be included on an investor list if either (i) the total consideration paid to all organizers and sellers with respect to such investor’s acquisition of the interest is less than \$25,000 or (ii) the organizer reasonably believes that such investor’s acquisition of the interest will not result in a reduction of the federal income tax liability of any corporation(s) that exceeds \$1 million in any single taxable year or \$2 million for any combination of taxable years and will not result in a reduction of the federal income tax liability of any noncorporate taxpayer(s) that exceeds \$250,000 in any single taxable year or a total of \$500,000 for any combination of taxable years. Id. § 301.6112-1T, A-8(b).

The investor list maintenance requirement applies broadly to any person who “organizes” or “sells” interests in a covered transaction. Id. § 301.6112-1T, A-5 & A-6. Because of the breadth of the new list maintenance rules, it seems likely that tax advisors will be required to consider the applicability of the investor list requirement to virtually any engagement, including many brief ones. Although we generally welcome the expansion of the investor list maintenance requirement and applaud the IRS’s efforts on this front, we believe that the IRS should consider carefully whether the expansion will impose an unnecessary burden on promoters, particularly in view of the potential \$100,000 penalty applicable under Code section 6708 for failure to maintain a list.

As drafted, the investor list requirement applies to any Section 6111(d)(1)(A) transaction (whether or not offered to a direct or indirect corporate participant), regardless of its size and regardless of whether the promoter will receive any material fees. As a result, the investor list requirement will apply to promoters (or other persons) who receive little or no

fee. This may be an unfair result. We recommend that the IRS consider amending the regulations to limit the scope of the investor list requirement to transactions that are required to be either registered pursuant to T.D. 8876 or disclosed pursuant to T.D. 8877. Although we commend the IRS for amending the regulations to provide that, in certain cases, certain investors are not required to be included on an investor list, at a minimum, we recommend that the investor list requirement be modified to apply only in those situations in which the \$100,000 promoter fee threshold set forth in the registration rules is met. It also may be appropriate to establish a reasonable dollar floor for the reduction in the taxpayer's tax liability that is similar to the projected tax effect test set forth in Section 1.6011-4T(b)(4) of the disclosure regulations.

B. Section 6111(d)(1)(A) Transactions. We believe that transactions that are subject to the investor list requirement generally should be the same transactions that are required to be either registered or disclosed. As described in Part II.B and C above, we believe that the IRS should replace the economic substance test in Section 301.6111-2T(b)(3) of the registration regulations with an objective six-factor test similar to the six-factor test that appears in Section 1.6011-4T(b)(3)(i) of the disclosure regulations. We also recommend that the "ordinary course of business" exception in Section 1.6011-4T(b)(3)(ii) of the disclosure regulations that applies in connection with such six-factor test also apply under Section (b)(3) of the registration regulations. The other exception to disclosure, that the IRS lacks substantial authority to support a contrary position (we recommend substituting this exception or a "no realistic possibility of success" exception for the "no reasonable basis for denial" exception, as described in Part I.D above), also should apply.

In addition, as described in Part II.C above, we recommend that the IRS eliminate the "other tax-structured transactions" standard set forth in Section 301.6111-2T(b)(4) of the registration regulations in favor of a Section (b)(4) standard that requires registration of transactions "the principal purpose of which is tax avoidance." For purposes of the investor list regulations, however, we recommend that the IRS expand the "principal purpose" standard to require investor list maintenance in situations where "a significant purpose" of a transaction is tax avoidance. Like the current regime, such a standard would trigger the investor list requirement with respect to some transactions that are not required to be registered. We believe that if the IRS does expand the "principal purpose" standard to a "significant purpose" standard, it also should adopt our recommendations in this Part III for narrowing the scope of the investor list requirement because the "significant purpose" standard is much more broad than the "principal purpose" standard and will subject many more transactions to the investor list requirement. In the alternative, if the IRS does not adopt our recommendations in this Part III for narrowing the scope of the investor list requirement, we believe that the IRS should use the "principal purpose" standard for investor list maintenance.

C. Other Issues. We believe that the persons required to maintain investor lists under Code section 6112 with respect to corporate tax shelters should be defined in a manner consistent with the definition of the term "tax shelter promoter" under Section 301.6111-2T(f) of the registration regulations (including the exclusion from such definition of persons

described in Q&A-30 and Q&A-33 of Section 301.6111-1T, as described in Part II.H above), so that the same persons who are required to register transactions also are required to maintain investor lists.

We recommend that the materials required to be retained pursuant to clause (9) of new A-17 of the temporary regulations be limited to materials provided to actual investors in a transaction, rather than to all potential participants.

We encourage the IRS to amend and clarify new A-18 of the temporary regulations. First, we recommend that the “substantially similar” standard be eliminated in favor of a “substantially identical” standard. We also believe that the phrase “utilizes a similar structure or is intended to produce similar tax benefits” is unclear and may permit overly broad interpretation. We recommend that the IRS amend the regulations to specify the intended breadth of such phrase.

The IRS also should consider addressing how the \$100,000 penalty for failure to maintain an investor list applies in situations where a list is maintained, but all of the required information is not included. The IRS either could adopt a substantial compliance standard under which no penalty will be imposed if a promoter’s partial compliance is in good faith, or could set forth lesser penalties for partial compliance.

IV. Administration and Enforcement.

A. Audit Program. We believe that the IRS should issue an advance notice soliciting comments on the administration and enforcement of the registration and investor list regulations. Specifically, we recommend that the IRS state in such advance notice that it intends to develop an audit program for tax shelter promoters in which the IRS would audit promoters’ compliance with the registration and investor list regulations. The procedures for such an audit would be similar to the procedures for standard taxpayer audits. Instead of choosing to audit taxpayers based on the examination of returns, the IRS would choose to audit promoters based on the tax shelter registrations (or absence thereof) filed by such promoters.

Code section 7601 gives the IRS broad audit authority with respect to all persons who may be liable to pay any “internal revenue tax.” Code section 6671(a) provides that the penalties set forth in Code sections 6707, which applies upon a tax shelter promoter’s failure to register a tax shelter or filing of false or incomplete information in connection with the registration, and 6708, which applies upon a tax shelter promoter’s failure to maintain an investor list or failure to make the list available to the IRS upon request, will be assessed and collected in the same manner as taxes and that any reference in the Code to “tax” will include such penalties. Accordingly, the IRS has the authority to develop an audit program for tax shelter promoters because the term “internal revenue tax” includes the penalties that may be imposed on tax shelter promoters for failure to register a corporate tax shelter or to maintain an investor list.

B. Obtaining Information When Corporate Tax Shelter is Discovered in the Field.

In the event that the IRS discovers a corporate tax shelter in the marketplace or such a shelter otherwise comes to the attention of the IRS, we suggest that the IRS adopt procedures for immediately obtaining information from tax shelter promoters that are similar to those set forth in Revenue Procedure 83-78.⁴ Specifically, the IRS would request investor lists and other documents with respect to the subject transaction from tax shelter promoter(s) who are marketing and selling the subject transaction. The promoter(s) would be required to make such information available to the IRS within 10 days of the request. Failure to provide the information requested may result in summonses being issued. After reviewing the information requested, the IRS may initiate an audit of one or more of the listed investors or the tax shelter promoter.

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⁴ 1983-2 C.B. 595. Revenue Procedure 83-78 which sets forth procedures for enforcing Code sections 6700 and 7408. Code section 6700 imposes a fine on any tax shelter organizer who, in connection with the organization or sale of interests in the tax shelter, makes or causes to be made a false or fraudulent statement on any material matter or makes a gross valuation overstatement as to any material matter. Code section 7408 allows the IRS to seek an injunction against a tax shelter organizer from engaging in conduct that violates Code section 6700.