

ADDITIONAL 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

The following comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These comments were prepared by individual members of the Corporate Tax Shelter Task Force of the Section of Taxation. Principal responsibility was exercised by George C. Howell, III and Caroline G. Root. The comments were reviewed by William M. Paul, Council Director for the Corporate Tax Shelter Task Force.

Although many of the members of the Section of Taxation who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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These comments are intended to supplement the comments on the corporate tax shelter regulations submitted by the Section of Taxation on August 29, 2000 (and corrected on September 18, 2000). As we stated in our prior comment letter, we commend 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 believe 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 make additional comments on the substance of the regulations.

I. List of Transactions that are not Tax Shelters for Purposes of the Regulations.

Section 1.6011-4T(b)(3)(ii)(D) of the tax return disclosure regulations provides that a transaction will not be a “reportable transaction” within the meaning of the disclosure regulations if the transaction is identified in published guidance as being excepted from disclosure under that section. Similarly, section 301.6111-2T(b)(5)(ii) of the tax shelter registration regulations provides that tax avoidance or evasion will not be considered a significant purpose of a transaction and, therefore, the transaction will not be required to be registered, if the IRS determines, by published guidance, individual ruling, or otherwise, that the transaction is not subject to the registration requirements. Such a determination also will apply for purposes of the investor list maintenance regulations. In Notice 2001-18, the IRS exercised its authority under the regulations and determined that certain leveraged leasing transactions that meet the requirements of Revenue Procedure 75-21 are not “tax shelters” for purposes of the registration requirements. We recommend that the IRS clarify that Notice 2001-18 also applies for purposes of section 1.6011-4T(b)(3)(ii)(D) of the tax return disclosure regulations. In addition, we recommend that the IRS or the Treasury Department issue guidance providing that the following transactions are not “reportable transactions” for purposes of the disclosure regulations or “tax shelters” under the registration regulations:

- Transactions that generate tax benefits listed in section 1.6662-4(g)(2)(ii) of the Treasury regulations (i.e., the purchasing or holding of an obligation bearing interest that is excluded from gross income under Code section 103; taking an accelerated depreciation allowance under Code section 168; taking the percentage depletion allowance under Code section 613 or 613A; deducting intangible drilling and development costs as expenses under Code section 263(c); establishing a qualified retirement plan under Code sections 401-409; claiming the possession tax credit under Code section 936; or claiming tax benefits available by reason of an election under Code section 992 to be taxed as a domestic international sales corporation, under Code section 927(f)(1) to be

taxed as a foreign sales corporation, or under Code section 1362 to be taxed as an S corporation).

- Transactions generating tax credits under Code section 29 or 42.
- The failure of a partnership to make a Code section 754 election.
- Other transactions expressly permitted by the partnership anti-abuse regulations in Treasury regulations section 1.701-2.
- Choice of entity or checking the box.
- Transactions permitted by the Supreme Court's decision in Cottage Savings.
- Partnership redemptions that use property rather than cash.
- Like-kind exchanges that are part of a sale of an asset.
- Substituting debt for equity or choosing to issue debt instead of equity.
- Transferring insurance operations to a subsidiary.

II. Amendment of "Filters" in Definition of "Other Reportable Transactions" in the Disclosure Regulations.

As we stated in our prior comment letter, we applaud the IRS's creation of an objective test in section 1.6011-4T(b)(3) of the disclosure regulations to determine which transactions other than listed transactions must be disclosed. However, we recommended that factors (D) and (F) be amended in order to avoid a significant amount of unnecessary reporting. Specifically, we recommended that factor (D) be amended to apply only to permanent book/tax differences because virtually 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, such book/tax timing differences are eliminated over time. We propose the following language for the amendment of factor (D):

(D) The expected treatment of the transaction for Federal income tax purposes in any taxable year differs or is expected to differ by more than \$5 million from the treatment of the transaction for purposes of determining book income as taken into account on the schedule M-1 (or comparable schedule) on the taxpayer's Federal corporate income tax return for the same period and such difference has not been and is not expected to be eliminated over time.

We also recommended that, because many transactions will result in U.S. tax consequences that differ from the foreign tax consequences of the transaction, 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 large number of transactions that do not have any relationship to corporate tax shelters of the type that are the target of the disclosure rules. We propose the following language for the amendment of factor (F):

(F) A non-U.S. party was included as a participant in the transaction to achieve a U.S. tax result that otherwise would not have been available and the expected characterization of any significant aspect of the transaction for Federal income tax purposes differs from the expected characterization of such aspect of the transaction for purposes of taxation of any party to the transaction in another country.

III. Amendment of “No Reasonable Basis for Denial” Exception.

Section 1.6011-4T(b)(3)(ii)(C) of the tax return disclosure regulations provides that a transaction will not be a “reportable transaction” within the meaning of the disclosure regulations if the taxpayer reasonably determines that there is no reasonable basis for denial of any significant portion of the expected tax benefits from the transaction. Similarly, section 301.6111-2T(b)(5)(i) of the tax shelter registration regulations provides that tax avoidance or evasion will not be considered a significant purpose of a transaction and, therefore, the transaction will not be required to be registered, if the tax shelter promoter reasonably determines that there is no reasonable basis for denial of any significant portion of the expected tax benefits from the transaction.

After several informal discussions with Treasury Department and IRS officials regarding the corporate tax shelter regulations, we would like to reiterate our recommendation that the “no reasonable basis for denial” exception in both the tax return disclosure and the registration regulations be amended to provide instead that disclosure and registration, respectively, are 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 eliminate disclosure and registration of many transactions in which the IRS should have little interest, which would make it easier for the IRS to enforce the disclosure and registration regulations and any penalties imposed for noncompliance with the regulations. Moreover, the objective “no substantial authority” rule would eliminate the need for inquiries into the adequacy of legal opinions and better encourage disclosure and registration in circumstances in which the state of legal authorities is uncertain.

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 would be easier for both taxpayers and the IRS to apply because an existing provision of the Treasury regulations describes such standard (see Treas. Reg. § 1.6694-2(b)). No provision of the Code or the Treasury regulations or any other precedential guidance defines or describes the “no reasonable basis for denial” standard. In addition, the “no realistic possibility of success” standard is a more objective standard that should assist the IRS in enforcing the regulations and any penalties imposed for noncompliance with the regulations.

We propose the following language for the revision of Section 1.6011-4T(b)(3)(ii)(C) of the disclosure regulations:

(C) The IRS lacks substantial authority to support a challenge to the taxpayer’s claimed treatment of the transaction under Federal tax law, taking into account the entirety of the transaction, any combination of tax consequences that are expected to result from any component steps of the transaction, and all relevant aspects of Federal tax law, including the statute and legislative history, treaties, authoritative administrative guidance, and judicial decisions that establish principles of general application in the tax law (e.g., *Gregory v. Helvering*, 293 U.S. 465 (1935)), and disregarding any unreasonable or unrealistic factual assumptions.

In addition, we propose the following language for the revision of Section 1.6011-4T(b)(3)(ii)(C) of the disclosure regulations and section 301.6111-2T(b)(5)(i) of the registration regulations:

(i) In the case of a transaction other than a transaction described in paragraph (b)(2) of this section, the IRS lacks substantial authority to support a challenge to the taxpayer’s claimed treatment of the transaction under Federal tax law, taking into account the entirety of the transaction, any combination of tax consequences that are expected to result from any component steps of the transaction, and all relevant aspects of Federal tax law, including the statute and legislative history, treaties, authoritative administrative guidance, and judicial decisions that establish principles of general application in the tax law (e.g., *Gregory v. Helvering*, 293 U.S. 465 (1935)), and disregarding any unreasonable or unrealistic factual assumptions.

IV. Amendment of Q&A-27 and -30 of Section 301.6111-1T of the Investor List Regulations.

The term “tax shelter organizer” was previously defined in Treasury regulations section 301.6111-1T, Q&A 26-33. The definition of “tax shelter promoter” set forth in section 301.6111-

2T(f) of the registration regulations cross-references those rules. In addition, the investor list rules under Treasury regulations section 301.6112-2T provide that a tax shelter “organizer” must maintain investor lists.

Q&A-26 of Treasury regulations section 301.6111-1T provides that a “tax shelter organizer” means a person principally responsible for organizing a tax shelter. If a person principally responsible for organizing a tax shelter has not registered the tax shelter by the day on which interests in the shelter are first offered for sale, any other person who participated in the organization of the tax shelter will be treated as a “tax shelter organizer.” Q&A-27 provides that a person principally responsible for organizing a tax shelter (a “principal organizer”) is any person who discovers, creates, investigates, or initiates the investment, devises the business or financial plans for the investment, or carries out those plans through negotiations or transactions with others. This definition presumably would include a tax advisor who creates or develops a tax planning strategy or negotiates the transaction that implements the strategy. In addition, Q&A-28 provides that participation in the organization of a tax shelter includes the performance of any act (directly or through an agent) related to the establishment of the tax shelter, including the following: (1) preparation of any document establishing the tax shelter (for example, articles of incorporation, a trust instrument, or a partnership agreement), (2) preparation of any document in connection with the registration (or exemption from registration) of the tax shelter with any federal, state, or local government body, (3) preparation of a prospectus, offering memorandum, financial statement, or other statement describing the tax shelter, (4) preparation of a tax or other legal opinion relating to the tax shelter, (5) preparation of an appraisal relating to the tax shelter, or (6) negotiation or other participation on behalf of the tax shelter in the purchase of any property relating to the tax shelter. Many of those functions typically would be performed by a tax advisor.

Q&A-30 provides that the performance of an act described in A-27 or A-28 will not constitute participation in the organization or management of a tax shelter unless the person performing the act is related to the tax shelter (or any principal organizer of the tax shelter) or the person participates in the entrepreneurial risks or benefits of the tax shelter. A person will be considered related to a tax shelter if the person is related to the tax shelter or a principal organizer of the tax shelter within the meaning of Code section 168(e)(4) or is employed by the tax shelter or a principal organizer of the tax shelter or has an interest (other than an interest as a creditor) in the tax shelter. A person will be considered a participant in the entrepreneurial risks or benefits of a tax shelter if the person’s compensation for performing an act described in A-27 or A-28 is contingent on any matter relating to the tax shelter (e.g., the compensation is based in whole or in part upon (i) whether interests in the tax shelter are actually sold or (ii) the number or value of the units in the tax shelter that are sold), or if the person will receive an interest in the tax shelter as part or all of the person’s compensation.

It is arguable that actions by a tax advisor that are described in A-27 or A-28 that otherwise would not constitute participation in the organization or management of a tax shelter will constitute such participation if the tax advisor creates or develops the tax planning strategy or negotiates its

implementation and, therefore, is treated as a “principal organizer” under A-27. In that case, the tax advisor would be treated as “related” to the principal organizer and the exception in Q&A-30 arguably would not apply. We believe that Q&A-27 and -30 need to be amended to clarify that a tax advisor who is engaged in tax planning for a non-contingent hourly fee and who has no entrepreneurial stake in the transaction will not be treated as participating in the organization or management of a tax shelter and, thus, will not be required either to register the transaction or to maintain an investor list with respect to the transaction.

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