August 7, 2003

Hon. Pamela F. Olson  
Assistant Secretary (Tax Policy)  
Department of the Treasury  
Room 1334 MT  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C.  20220

Hon. Mark Everson  
Commissioner  
Internal Revenue Service  
Room 3000 IR  
1111 Constitution Avenue, N.W.  
Washington, D.C.  20224

Re: Final Regulations Under  
I.R.C. §§ 6011, 6111 and 6112

Dear Assistant Secretary Olson and Commissioner Everson:

On behalf of the Section of Taxation of the American Bar Association, I am pleased to submit the following comments on final regulations under sections 6011, 6111 and 6112 of the Internal Revenue Code. The comments were developed by members of the Section’s Tax Shelter Task Force, reflect input from numerous members of the Section, and have been reviewed and approved by the Section’s Council. However, 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.

I. INTRODUCTION

We commend the Treasury Department and the Internal Revenue Service for their continuing effort to strengthen the effectiveness of the regulations prescribing disclosure and investor list maintenance requirements. We continue to support the notion that ample early sunshine on potentially abusive transactions is the most powerful way to achieve that goal.

In general, we believe that the final regulations and the accompanying “angel lists” (published in Rev. Proc. 2003-24 and 2003-25) represent a significant improvement over earlier versions; and we are very pleased to see that they reflect a number of the suggestions made in our prior comment letter of February 3, 2003. We remain concerned, however, that some aspects of the regulations -- including, especially, the “confidentiality” and “book-tax” triggers -- remain unclear, overly broad and/or unduly burdensome for taxpayers to comply with, and may prove difficult for the IRS to administer in an efficient and effective manner. We therefore are suggesting several additional modifications to the regulations and the angel lists which are intended to alleviate many of these concerns in ways which ought not detract from the overall objectives or effectiveness of the regulations.
I. SUMMARY OF RECOMMENDATIONS

Our principal recommendations are as follows:

• More clearly define the “transaction” concept, providing guidance on when certain transactions should be viewed separately from one other.

• Carve litigation judgments and settlements (and other dispute settlements) out of the “confidentiality” trigger or, more fundamentally, out of the definition of a “transaction.”

• Remove “implied” confidentiality agreements or understandings as a basis for applying the confidentiality trigger.

• Clarify that disclosure of the tax treatment or tax structure of a transaction can be satisfied by disclosure of redacted documents.

• Expand the “securities law” exception to the confidentiality trigger to all other types of laws that restrict disclosure of confidential information.

• Clarify and expand the “merger and acquisition” exception to the confidentiality trigger to cover certain less than 50% acquisitions and certain non-corporate acquisitions.

• Establish an additional “angel list” excepting various types of legitimate business transactions that commonly involve confidentiality features.

• Clarify the level of due diligence required for non-accountant advisers to determine whether a transaction generates a book-tax difference.

• Modify the requirement that, for purposes of the book-tax trigger, the gross assets of related non-public company business entities must be aggregated in applying the $250 million test.

• Clarify that the furnishing of required tax information statements do not constitute the making of “tax statements” for purposes of the list maintenance rules.

• Add items to the existing loss transaction and book-tax “angel lists.”

• Clarify, preferably by way of specific examples, application of the reportable transaction effective date rules for pre-2003 transactions.
A. **Definition of “transaction”**.

Under the final regulations, the term “transaction” is defined to include “all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan.” Treas. Reg. §1.6011-4(b)(1). The broad sweep of this definition may cause linkage of certain non-abusive transactions or activities that should be treated separately. Additional guidance in this regard would be especially helpful in the areas discussed below.

1. **Formation of investment entities.**

Organizers and sponsors of investment funds are concerned that when a fund is formed, there is always a possibility, and often a likelihood, that the fund will at some point enter into one or more sale transactions that result in section 165 losses above the applicable disclosure threshold. It should be sufficient that, if and when such losses occur, they are then disclosed as reportable transactions. However, the mere formation of an entity will be treated as a separate transaction from any subsequent transactions or activities that the entity may undertake, unless the entity was formed with the intention that it would engage in specific subsequent transactions that would or might cause the loss transaction or other reportable transaction triggers to come into play.

2. **Multiple-lot sales of securities to unrelated buyers.**

Owners of publicly-traded securities may sell multiple lots of a security on the same day, but in separate trades which are priced independently. In some cases, the seller knows that each lot is being sold to a different buyer. In other cases, the seller may not know the identity of the buyer or buyers. The regulations should clarify that such multiple lot sales will not be treated as a single transaction, unless the seller knows or has reason to know that all of the lots were sold to the same buyer or to multiple buyers who are related individuals or entities.

3. **Litigation judgments and settlements.**

Taxpayers do not become parties to litigation to avoid taxes, yet litigation judgments and settlements, as well as dispute settlements outside of litigation, would appear to constitute “transactions” for purposes of the reportable transaction rules. No special tax return disclosure should be necessary in these situations. At the very least, litigation judgments and settlements should be excepted from the confidentiality trigger.
B. **Confidential transactions.**

1. **Implied confidentiality.**

   The regulations state that a transaction is considered offered under conditions of confidentiality “if the taxpayer’s disclosure of the transaction is limited in any manner by an express or implied understanding or agreement.” Treas. Reg. §1.6011-4(b)(3)(i). The “implied” understanding or agreement concept is vague and has the potential for creating substantial uncertainty as to when particular courses of dealing may create unstated expectations of confidentiality. We think it sufficient that this category of reportable transactions be implicated only if there is an express agreement or understanding (either written or oral) regarding confidentiality. In making this recommendation, we recognize the difficulty of dealing with so-called “wink and nod” situations. Any change in the regulations relating to implied confidentiality should make clear that reportable transaction treatment will result if there is any discussion or written communication between the parties which references or alludes to confidentiality in a way that suggests that it is understood to be a condition of the transaction.

2. **Redacted documents.**

   The confidentiality trigger is designed to enable the Service to focus early attention on often controversial tax planning and structuring techniques that may prove to be abusive. We believe that this objective can be achieved without revealing the names or other identifying details of the taxpayers involved in a transaction. It should suffice to describe the type of taxpayer and other generic information that may be relevant to its tax status (e.g., “C corporation”; “U.S. partnership”; “PFIC incorporated in a non-treaty country”). We recommend that the regulations be revised to clarify that names and other specific identifying details may be redacted from documents and descriptions which are relevant to the tax treatment or structuring of the transaction without causing the confidentiality trigger to apply.

3. **“Securities laws” exception.**

   In many situations, a taxpayer’s ability to disclose certain information about consummated or proposed transactions may be limited by law. Under the final regulations, a transaction is not considered confidential if disclosure of its tax treatment or structure is restrained under securities laws. We see no reason why this exception should not extend to other types of laws (federal or non-federal), that restrict a taxpayer’s ability to disclose information that might relate to the tax treatment or structure of a transaction – e.g., the Financial Modernization Act of 1999 (“Gramm-Leach-Bliley Act”).
4. **“Mergers and acquisitions” exception.**

   a. **Historic business assets.**

      The M&A exception to the confidentiality trigger applies to acquisitions of corporate assets that are used in an active trade or business that the purchaser intends to continue. There may be instances when the purchaser will continue to use the acquired assets in an active trade or business, but it will not be clear that the purchaser’s trade or business would be viewed as a continuation of the sellers’ historic trade or business. Such acquisitions, we believe, should nonetheless be covered by the M&A exception.

   b. **Controlling stock interests.**

      Acquirers in stock acquisitions often acquire a substantial interest that represents 50% or less of the target company stock, but nonetheless provides effective control of the corporation. Such acquisitions typically entail the same kinds of confidentiality considerations, but are not currently eligible for the M&A exception, (which requires the acquisition of a greater than 50% stock interest). Consideration should be given to expanding the M&A exception to include stock acquisitions in excess of some lower threshold (e.g., 35%), provided effective control of a corporation is thereby obtained.

   c. **Non-corporate acquisitions.**

      Consideration also should be given to expanding the M&A exception to similar acquisitions of assets from, or equity interests in, non-corporate entities (e.g., LLCs or partnerships). Such transactions have become increasingly prevalent in recent years, and typically have confidentiality features similar to those found in corporate acquisitions.

   d. **Leaks.**

      The M&A exception currently permits a temporary period of confidentiality until no later than the earlier of (i) the date of the public announcement of discussions relating to the transaction, (ii) the public announcement of the transaction, or (iii) the execution of the acquisition agreement. Not infrequently, however, transactions may be publicized through unauthorized “leaks” prior to being officially announced. It would be inappropriate to require premature disclosure of the tax treatment or tax structure of a transaction in such circumstances in order to avoid the confidentiality trigger. Doing so would force companies to abandon policies of not commenting on leaked information or announcing transactions only when there is a binding agreement. We therefore recommend that the M&A exception be clarified to provide that disclosure is required only upon (i) the execution of a definitive agreement, or an earlier authorized public announcement of the transaction or negotiations relating to it.
5. **Litigation/dispute settlements.**

Parties to settlements of litigation and pre-litigation disputes do not want it known that they even have agreed to a settlement, let alone on what terms the settlement has been reached. This is particularly common with employment and product liability litigation, where employers and manufacturers often fear “copycat” suits if the fact of a settlement becomes public. Given the public nature of litigation filings, even redacted disclosure of the “tax treatment or structure” of a settlement arrangement may provide clues to the parties’ identities or the settlement terms. Similarly, Parties to a divorce typically also desire that their settlement to be kept entirely confidential, including any tax features of the settlement. If our earlier recommendation that litigation and dispute settlements excluded from the definition of “transaction” is not adopted, we urge alternatively that the regulations be revised to permit confidentiality with respect to the tax treatment and structure of such settlements.

6. **Routine commercial transactions.**

In many routine business transactions tax planning is not a significant consideration, but confidentiality is nonetheless required for business reasons (e.g., protection of trade secrets, know-how or economic advantage). In theory, it should be a simple matter to limit confidentiality provisions in such agreements to non-tax matters, particularly if disclosure of names and identifying details is not required. In practice, however, identifying and carving out the tax treatment and structure aspects from confidentiality agreements and provisions is proving for many taxpayers to be a time-consuming, costly and uncertain task: forms must be revised and reprinted; longstanding commercial agreements must be amended; and judgments must be reached as to whether certain financial or other commercial terms of a particular transaction are also relevant to the tax treatment or structure of the transaction. In addition, many taxpayers are not sophisticated enough to ask their tax advisor to review their confidentiality agreements and, therefore, may unknowingly become subject to the disclosure rules. These burdens and complexities could be significantly lessened if specific types of routine commercial transactions were exempted, via another “angel list”, from treatment as confidential transactions. Possible candidates for such a list include:

- Purchase and sale of inventory for cash or trade credit of no more than 90 days.
- Procurement of materials that will be used to produce inventory (e.g., raw materials, supplies and feedstocks).
- Purchase or sale of business, investment or personal-use real estate.
- Furnishing or obtaining personal services (other than tax planning or tax return preparation services).
- Non-exclusive licenses of intellectual property and technology.
- Employee loan/sharing agreements.
• Contracts for the provision of routine outsourced services, such as security, maintenance cleaning, payroll and information technology support.

• Loans made by regulated financial institutions in the ordinary course of their lending businesses (without participation features).

C. **Book-tax difference due diligence.**

Many tax advisers are not accountants; and even those tax lawyers who are also CPAs, or otherwise have accounting knowledge, typically do not practice in the accounting field. On most matters addressed by the regulations, a non-accountant tax adviser should have sufficient expertise to determine whether a transaction constitutes a reportable transaction. However, only accounting professionals are best qualified to determine whether a transaction gives rise to a book-tax difference and, if so, the extent of that difference. Absent reason to think otherwise, tax lawyers and other non-accountant tax advisers should be able to rely on a statement by knowledgeable client financial personnel or the client’s outside accountants that no book-tax difference exists, or that any difference is insufficient to meet the threshold. Non-accountants should not be expected to separately retain accountants or to perform due diligence that requires accounting expertise in order to comply with these rules.

D. **$250 million gross assets test.**

We applaud the decision to raise the gross asset threshold for requiring non-public entities to report significant book-tax differences from $100 million to $250 million. However, there remain situations where an entity might be a required to report book-tax differences as a result of the entity aggregation rules, even though it may have no way of knowing that those rules cause it to exceed the threshold. For example, multiple closely-held business entities are often owned by different members of the same family who, for whatever reason, may not have access to financial information about each other’s business entities. We recommend that the gross assets of multiple business entities be aggregated only if they are in the same chain of ownership, or if there are common owners, officers or financial employees of the relevant entities.

E. **Information returns as “tax statements”.**

Many taxpayers are required to provide various types of tax information statements (e.g., Forms, W-2s, K-1 and 1099) to their employees, service providers, owners, lenders or borrowers. Because such statements report items of income, gain, deductions and the like, there is some concern that they could be viewed as “tax statements” for purposes of the list maintenance regulations. However, taxpayers providing tax information statements are not providing tax advice, but simply documenting payments made or received, as required by law. The regulations should make clear that such taxpayers will not be treated as “material advisors” unless they make tax statements separate from the information returns.
F. **Expand existing “angel lists”.**

Identified below are some additional ordinary business transactions that should be considered as new angel list items for the “loss transaction” and “book-tax” triggers.

**With respect to loss transactions:**

- “Qualifying basis” should include certain non-cash inclusions that increase or decrease tax basis during the period of the taxpayer’s ownership of a debt instrument or other security – including: original issue discount; market discount; amortizable bond premium; section 446 imputed interest income; and section 305 deemed dividends.
- The “qualifying basis” rules should apply to foreign securities purchased for cash (under the current rules, if there are any section 988 losses on such securities, the entire loss would be reportable.)

**With respect to book-tax differences:**

- Add installment notes reportable under section 453.
- Clarify that the exception for the REIT dividends paid deduction extends to REITs the shares of which are not publicly-traded, but widely held. For example, some new REITs are initially engaging in Rule 144A offerings of their common stock, rather than public offerings. A REIT should be considered “widely held” for this purpose if no individual or entity owns, directly or constructively, more than 25% of its stock.
- Add tax losses attributable to basis increases for residual interests in REMICs under section 860C(d)(1), during the period of the taxpayer’s ownership.

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1 As observed in our earlier comments, we continue to believe that the book-tax difference trigger will prove for many taxpayers to be very burdensome and of uncertain application from a compliance standpoint. The substantial number of “angel list” exceptions is certainly appreciated, but simply keeping track of these items and making sure that they in fact apply will no doubt add considerably to the compliance burden. We urge Treasury and the Service to closely monitor taxpayer and field experience with the book-tax trigger and, if feasible, to move toward replacing it with a more comprehensive Schedule M regime.

2 We recognize that certain otherwise non-abusive items, such as installment notes, can be combined with other elements of multi-step transaction or arrangement items in an abusive manner. However, using a “could be part of an abusive transaction” standard could result in virtually any transaction being excluded from angel list eligibility. So long as the overall transaction is otherwise required to be reported under the regulations (e.g., by reason of the confidentiality section 165 loss or book-tax triggers), the components of those transactions that are considered ordinary commercial transactions on a stand-alone basis should still be eligible for exception.
• Add book-tax differences attributable to the acquisition, ownership and disposition of mortgage servicing rights.

• In section 368 reorganizations with section 356 boot, the measure of taxable boot may differ from the book gain or income attributable to the boot. Given that other aspects of tax-free reorganization transactions are exempted from reporting and listing based on book-tax differences, this aspect should be excepted as well.

G. Effective date rules.

The effective date transition rules of the regulations for pre-2003 transactions are complicated and difficult to apply absent full knowledge of the significant changes that were made in several earlier versions of the regulations. It would be helpful if illustrative examples were added to the regulations, addressing particular scenarios that are likely to arise – for example, situations involving S corporations or partnerships, the “2 out of 6” tax shelter characteristics test, and the various subjective-type exceptions that were available under earlier versions of the regulations (e.g., consistent with customary commercial practice).³

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We appreciate Treasury’s willingness to consider further refinements to these important regulations, and hope that the foregoing comments will be helpful toward that end. We recognize that the disclosure rules inevitably will sweep in some legitimate transactions, and that the effectiveness of the regulations will be jeopardized if they are drawn too narrowly or contain significant exceptions based on subjective-type factors that are susceptible to aggressive taxpayer interpretation. However, especially in light of the substantial new nondisclosure-related penalties that Congress is likely to adopt in the near future, it is important that the definitional parameters of “reportable transactions” be honed and clarified as much as possible. In all events, consistent with public statements that have been made by various Treasury and IRS officials, it is important that these rules be given a “common sense” reading, and that good-faith compliance efforts by taxpayers be recognized by examining agents where occasional and non-deliberate violations of such rules occur.

³ If this suggestion is of interest, we would be happy to develop specific proposed examples along these lines for Treasury’s consideration.
We would be pleased to meet with Treasury and IRS representatives to discuss these comments in further detail. Please contact the undersigned (at 202/383-0120) or Stuart Lewis, the Section’s Vice-Chair for Government Relations (at 202/452-7933), if that might be helpful.

Very truly yours,

Herbert N. Beller
Chair, Section of Taxation

cc: Eric Solomon (Deputy Assistant Secretary - Regulatory Affairs)
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