September 9, 1999

Honorable William V. Roth, Jr.
Chairman
Committee on Finance
U.S. Senate
104 Hart Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

As you know, the Section of Taxation of the American Bar Association has been very concerned about the increased use of tax shelter products by business taxpayers. We testified on this subject before the Ways and Means Subcommittee on Oversight (March 10, 1999) and the Senate Finance Committee (April 27, 1999). In each case we expressed our growing alarm with the aggressive marketing of tax "products" that have little or no purpose other than the reduction of Federal income taxes. We offered specific recommendations that we believe will aid in addressing our concern. Copies of our written statements are attached. They contain more detailed discussions of the issues and some possible remedies.

Subsequent to the hearings, the Treasury Department released its corporate tax shelter "white paper", and the Staff of the Joint Committee on Taxation submitted its report on penalties, which included an analysis of corporate tax shelters. In addition, Congressman Lloyd Doggett introduced H.R. 2255, 106th Cong., 1st Sess. (1999).

The Treasury report, the Joint Committee report and H.R. 2255 all propose an expansion of the disclosure requirements in the case of transactions with certain tax characteristics. While the standards for disclosure differ, the items to be disclosed closely follow the specific recommendations contained in the Tax Section's March 10 testimony. Of particular significance, both reports and H.R. 2255 propose that a senior corporate officer attest to the accuracy of the facts and assumptions on which a transaction required to be disclosed is based. We believe this requirement would serve to eliminate many tax shelters since such transactions are often based on dubious facts or questionable assumptions.

We were honored to have been given the opportunity to appear before the Oversight Subcommittee, and we are pleased that our disclosure recommendations are reflected in the Treasury and Joint Committee Staff reports and H.R. 2255. Important details, such as the time of disclosure and the penalties applicable in the case of inaccurate or nondisclosure, will need to be determined by your Committee. However, we think the thorough analysis contained in the two reports clearly indicates that additional information should be required where benefits from a tax shelter product are claimed on a taxpayer's return. We urge the Committee to adopt appropriate new disclosure rules, and we offer our assistance to the Committee in its deliberations.

In addition, to meaningful tax return disclosure, we believe that corporate tax shelter legislation should broaden the substantial understatement penalty to cover outside advisors, promoters and "tax indifferent parties" and articulate a clear Congressional policy that existing enforcement tools should be utilized to stop the proliferation of large tax shelters.

In our April 27 testimony before the Senate Finance Committee we also recommended enactment of legislation confirming that, where the judicial economic substance doctrine otherwise applies, the nontax considerations must be meaningful in relation to the potential tax benefits. We think this represents present law and, thus, our recommendation would constitute a mere codification of the law as it exists today. Nevertheless, we think such a legislative reinforcement would preclude assertions by some proponents of tax shelter products to the contrary.
Should the Committee decide to codify a "meaningful" standard of economic substance in the manner we suggest, we would be pleased to assist you and your staff in this work. If the Committee chooses not to legislate with respect to the economic substance issue, we encourage you to direct the Treasury Department and the Joint Committee Staff to evaluate legislative and administrative options for applying the economic substance doctrine of existing law more effectively.

This letter is sent on behalf of the Section of Taxation. Approval by the House of Delegates or the Board of Governors of the American Bar Association has not been sought. Accordingly, this letter should not be construed as representing the position of the Association.

An identical letter has been sent to Senator William V. Roth, Jr., Chairman of the Senate Committee on Finance.

Sincerely,

Paul J. Sax
Chair, Section of Taxation

cc: Daniel Moynihan, Ranking Democratic Member, Senate Committee on Finance
Lawrence H. Summers, Deputy Secretary, Department of the Treasury
Donald Lubick, Assistant Secretary (Tax Policy), Department of the Treasury
Lindy Paull, Chief of Staff, Joint Committee on Taxation