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September 24, 2003

The Honorable William M. Thomas
Chair
House Ways & Means Committee
U.S. House of Representatives
2208 Rayburn
Washington, DC 20515

Dear Chairman Thomas:

This letter¹ addresses certain provisions contained in H.R. 2896, the *American Jobs Creation Act of 2003*. In particular we address the application of strict liability penalties for failure to disclose a “reportable transaction” under Section 6011.

The Tax Section has been studying and commenting upon the recent proliferation of tax shelters since early 1999. In April of 1999 we stated that “the corporate tax shelter phenomenon poses substantial issues for the tax system”². At that time we urged Congress to impose penalties on taxpayers

¹ Submission of this letter was approved by the Executive Committee of the Tax Section. Contributions and comments concerning the letter were received from Kimberly S. Blanchard, Peter C. Canellos, David P. Hariton, Andrew N. Needham, Richard L. Reinhold and Michael L. Schler.

² New York State Bar Association Report on Corporate Tax Shelters, No. 950, dated April 23, 1999.

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taking inappropriate aggressive positions in tax motivated transactions, without “reasonable clause” or “good faith” exceptions. Since that time we have consistently supported administrative and legislative efforts to address the proliferation of tax shelters³, including endorsing the adoption of broader disclosure requirements for taxpayers who participate in tax shelter transactions, together with appropriate penalties for non-compliance.

The tax shelter provisions of H.R. 2896, the *American Jobs Creation Act of 2003*, propose a new Section 6707A, which would establish a penalty regime for failure to disclose a "reportable transaction" under Section 6011. Such penalties would apply without any exception for “reasonable cause, “good faith” or similar excuses. The only exception permitted in the legislation is a non-appealable waiver by the Commissioner of the Internal Revenue. We refer herein to this sort of liability regime as “Strict Liability”.

The penalties provided for in H.R. 2896 range from \$10,000 to \$200,000, depending upon whether the taxpayer is an individual or a corporation and whether the underlying transaction is "listed." New Section 6707A imposes Strict Liability penalties without regard to whether the reported tax treatment of the underlying transaction is ultimately sustained or, indeed, whether the underlying transaction bears any of the traditional indicia of a tax shelter.

³ See, for example, NYSBA Report No. 977 concerning Codification of Economic Substance, dated July 25, 2000; NYSBA Report No. 979, (letter relating to Section 6662A, mandating enhanced understatement penalties in certain tax shelter circumstances), dated September 18, 2000; NYSBA Report No. 1019 on Tax Shelter Legislation, dated August 27, 2002; NYSBA Report No. 1033 concerning Potentially Abusive Tax Shelter Regulations, dated June 6, 2003.

We have consistently endorsed Strict Liability penalties in certain circumstances where the taxpayer's position is ultimately found to be incorrect. We have also supported enhanced disclosure requirements. What H.R. 2896 essentially does is merge those two schemes – imposing Strict Liability for mere failure to disclose, regardless of whether the underlying position taken by the taxpayer was correct or even whether the underlying transaction was tax motivated.

We continue to support enhanced disclosure requirements and the imposition of significant penalties for non-compliance. As we have previously noted, however, disclosure regimes tend to be over broad in their sweep. This, in itself, is not a problem. However, we strongly believe that it would be a serious mistake to apply the same Strict Liability standards to disclosure failure as would be applied under accuracy related penalties. Accuracy penalties are only imposed if the taxpayer actually loses on the merits. Strict Liability penalties for disclosure failures would likely lead to the imposition of penalties in otherwise non-tax motivated transactions and do little to deter abusive transactions.

Since we began serious consideration of the tax shelter phenomenon, we have spent considerable time attempting to come up with an appropriate definition of a “tax shelter”. Treasury and IRS have devoted far more time to the same question. We have ultimately concluded that it is impossible to precisely define what a “tax shelter” is. Nonetheless, we have supported disclosure requirements for “tax shelters”, even if the definition was overbroad. We have further supported the imposition of Strict Liability penalties on “tax shelters”, even if defined over broadly, *provided* that the taxpayer loses on the merits.

In our most recent submission on tax shelters⁴ we addressed the considerable over breadth of the existing disclosure regulations. Two things

⁴ See NYSBA Report No. 1033, *Id.*

are clear to us. First, that the existing regulations apply to many transactions that are not “tax shelters” in the traditional sense. Second, for many regular business transactions, it is difficult to discern whether or not a technical disclosure requirement exists under the regulations.

We believe that the final regulations under Section 6011 represent an important step forward in Treasury’s effort to curb abuse. Their underlying rationale, however, is that truly abusive transactions are less likely to escape detection under rules that establish a less discriminating screen for distinguishing between abusive and legitimate business transactions. By attempting to eliminate subjectivity from the equation, they are deliberately over-inclusive. Specifically, they reject the traditional definition of a tax shelter in favor of an identified set of attributes that tax shelters often share with other transactions (e.g., confidentiality). As we have stated in prior reports, the disclosure and listkeeping regulations under Section 6011 are also ambiguous in many respects, which we believe will inevitably lead to failures to disclose that reflect good faith mistakes about their scope or inadvertence by honest taxpayers.

We believe one result of enactment of H.R. 2896 in its current form will be routine disclosure by well-advised taxpayers of almost every business transaction, simply to avoid the possibility of penalties. Less well-heeled taxpayers may not have that luxury. These taxpayers would face the prospect of penalties for failure to disclose many routine non-tax motivated transactions that happen to be caught by one of the disclosure filters. Absent a specific waiver of penalties from the Commissioner, such taxpayers will be out of luck.

We attach several examples as an Appendix to this letter. Our intention is to demonstrate that certain fairly straight forward transactions where the taxpayer is represented by competent counsel (though not necessarily a tax expert) could result in Strict Liability penalties. We also show how a taxpayer well advised by a tax specialist could avoid such

penalties on a far more aggressive transaction by following the disclosure requirements.

One area we believe can reasonably be distinguished from the foregoing concerns involves listed transactions. In the case of transactions which the IRS has described and listed⁵, we believe taxpayers and promoters have received notification with sufficient specificity of what triggers a disclosure obligation that imposition of penalties under a more stringent standard is appropriate.⁶

For the foregoing reasons, although the Tax Section continues to support Strict Liability penalties for tax deficiencies arising from “tax shelters” where the taxpayer loses on the merits, we think that Strict Liability is not appropriately married to the disclosure regime. We do generally support penalties for non-disclosure, provided they are tempered by exceptions designed to exclude legitimate non-motivated tax transactions. We also support enhanced penalties under more stringent circumstances for taxpayers and promoters failing to disclose listed transactions. We express no view at this time concerning the appropriate standards for mitigation of penalties for failure to disclose, though we would be happy to comment further on that specific matter if that would be helpful.

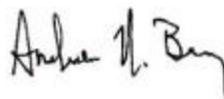
⁵ See, e.g., Treas. Reg. §1.6011-4 for details of listed transactions. Notice 2001-51 (“listing” 16 transactions). Subsequent Notices have added additional transactions to the “listed” category.

⁶ We note, however, that as listed transactions include not only the transactions expressly described by the IRS, but “substantially similar” transactions, some care must be taken in imposing enhanced liability in the “substantially similar” transaction category.

September 24, 2003

Please feel free to contact the undersigned if you wish to discuss our views on this issue in greater detail. As always, the Tax Section welcomes the opportunity to assist your efforts in any way we can.

Respectfully submitted,

A handwritten signature in black ink that reads "Andrew N. Berg". The signature is written in a cursive style with a large initial 'A' and a long, sweeping underline.

Andrew N. Berg
Chair

cc: Robert Winters
James D. Clark
Janice Mays
John Buckley