MEMO# 15322

November 1, 2002

TREASURY RELEASES NEW TAX SHELTER REGULATIONS; CONFERENCE CALL SCHEDULED FOR NOVEMBER 7

[15322] November 1, 2002 TO: ACCOUNTING/TREASURERS COMMITTEE No. 49-02 TAX COMMITTEE No. 35-02 UNIT INVESTMENT TRUST COMMITTEE No. 25-02 RE: TREASURY RELEASES NEW TAX SHELTER REGULATIONS; CONFERENCE CALL SCHEDULED FOR NOVEMBER 7 The Treasury Department ("Treasury") and the Internal Revenue Service ("IRS"), pursuant to an announcement earlier this year of an initiative to combat abusive tax shelter transactions, released amended temporary and proposed regulations under sections 6011, 6111 and 6112 of the Internal Revenue Code (the "Code"). As discussed below, the amended regulations provide certain exceptions for regulated investment companies ("RICs") that were suggested by the Institute.1 The amended regulations provide modified rules relating to the disclosure of reportable transactions by certain taxpayers on their Federal income tax returns under section 6011, including conforming changes to the rules regarding the registration of confidential corporate tax shelters under section 6111. The amended regulations under section 6112 generally require organizers and sellers (collectively called "material advisors") of tax shelters to maintain lists of persons who participated in transactions required to be registered under section 6111 and who participated in reportable transactions subject to disclosure under section 6011.2 Tax Shelter Disclosure Statements The disclosure regulations revise the categories of transactions that must be disclosed by a taxpayer on its return to now require that taxpayers disclose any transaction that falls under any one of the following six categories: 1. listed transactions – a transaction that is the same or substantially similar to a transaction that the IRS has already determined to be a tax avoidance transaction and has been identified as such in published guidance. 1 See Institute Memorandum to Tax Committee No. 27-02, dated September 5, 2002. 2 Treasury has proposed that legislation be enacted that would modify section 6111 to require registration of transactions that are required to be disclosed under section 6011. The IRS and Treasury intend to revise the regulations under section 6111 if such legislation is enacted. 2 2. confidential transactions – a transaction that is offered under condition of confidentiality, or where disclosure of the structure or tax aspects of the transaction is limited by an express or implied understanding or agreement with or for the benefit of any person who makes or provides a statement as to the potential tax consequences that may result from the transaction. Transactions will not be deemed to be confidential if conditions are only imposed to comply with certain securities laws, or if every person who provides a statement regarding tax consequences that may result from the transaction provides express written authorization to taxpayers permitting the taxpayers to disclose, without limitation, information about the transaction. 3. transactions with contractual protection - transaction for which the taxpayer has

obtained or been provided with contractual protection against the possibility that part or all of the intended tax consequences from the transaction will not be sustained, including for example, rescission rights and tax indemnities. 4. loss transactions - any transaction resulting in, or that is reasonably expected to result in, a taxpayer claiming a loss under section 165 of at least – $10 million in any single taxable year or $20 million in any combination of taxable years for corporations; $5 million in any single taxable year or $10 million in any combination of taxable years for partnerships or S corporations, whether or not any losses flow through to one or more partners or shareholders; $2 million in any single taxable year or $4 million in any combination of taxable years for individuals or trusts, whether or not any losses flow through to one or more beneficiaries; or $50,000 in any single taxable year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership, if the loss arises with respect to a section 988 transaction (as defined in section 988(c)(1) relating to foreign currency transactions). 5. transactions with a significant book-tax difference - a transaction where the treatment for Federal income tax purposes of any item or items from the transaction differs, or is reasonably expected to differ, by more than $10 million on a gross basis from the treatment of the item or items for book purposes in any taxable year. This category is only applicable to the following entities: taxpayers that are reporting companies under the Securities Exchange Act of 1934 (15 USCS 78a) and related business entities; or business entities that have $100 million or more in gross assets. 3 6. transactions involving a brief asset holding period - a transaction resulting in, or that is reasonably expected to result in, a tax credit exceeding $250,000 (including a foreign tax credit) if the underlying asset giving rise to the credit is held by the taxpayer for less than 45 days. A taxpayer that is required to disclose a transaction under these regulations must do so on Form 8886, “Reportable Transaction Disclosure Statement,” which must be attached to the taxpayer's Federal income tax return for each taxable year for which the taxpayer's Federal income tax liability is affected by the taxpayer's participation in the transaction. A taxpayer filing the Form 8886 for the first time also must submit a copy of the disclosure statement to the IRS Office of Tax Shelter Analysis. A taxpayer must retain a copy of all documents and other records related to a transaction subject to disclosure that are material to an understanding of the facts of the transaction, the expected tax treatment of the transaction, or the taxpayer's decision to participate in the transaction. Documents must be retained until the expiration of the statute of limitations applicable to the final taxable year for which disclosure of the transaction was made in accordance with the requirements of this section. Documents that must be maintained during the applicable limitations period generally include, but are not limited to, (i) marketing materials related to the transaction; (ii) written analyses used in decision-making related to the transaction; (iii) correspondence and agreements between the taxpayer and any advisor, lender, or other party to the reportable transaction that relate to the transaction; (iv) documents discussing, referring to, or demonstrating the tax benefits arising from the reportable transaction; and (v) documents, if any, referring to the business purposes for the reportable transaction. Taxpayers may request a ruling as to whether a transaction is subject to the disclosure requirements. They may also elect to disclose a transaction that they are unsure about and indicate on the disclosure statement that the taxpayer is uncertain whether the transaction is required to be disclosed and that the disclosure statement is being filed on a protective basis. The effective date of these regulations is January 1, 2003. Exemptions For Regulated Investment Companies Following the Treasury announcement of the initiative to ensure that Treasury and the IRS have the tools to combat abusive tax avoidance transactions, the Institute submitted comments suggesting certain exceptions for RICs from any revisions to the existing tax shelter regulations. Specifically, we requested that RICs be exempt from disclosure requirements with respect to (1) loss transactions, (2) transactions with brief asset holding periods and

(3) transactions with significant book-tax differences because such disclosure requirements could force the disclosure of many routine, non-tax motivated portfolio transactions. We are pleased to inform you that the revised regulation grants RICs an exemption from the disclosure requirements regarding loss transactions and transactions with significant book-tax differences; a RIC exemption is not provided, however, with respect to transactions with brief asset holding periods, which may generate large foreign tax credits. 4 Conference Call – Action Requested The IRS has scheduled a public hearing on the new tax shelter regulations for December 11, 2002. Written comments must be submitted by December 2, 2002.3 A conference call has been scheduled for Thursday, November 7, 2002 at 2:00 p.m. EDT to discuss the tax shelter regulations. The dial-in number for this call is 800-475-0233 (passcode: "Tax Shelter Regulations"; moderator: Lisa Robinson). If you would like to participate in this call, please complete the attached response form and fax it to Brenda Turner by noon, Wednesday, November 6, 2002. If you would like to discuss a specific issue related to either of the above topics, please provide your comments on the attached response form or contact me at 202-326-5835 or lrobinson@ici.org. If you will be unable to participate in the conference call, you may contact the undersigned at the telephone number or e-mail address listed above to discuss the regulations. Lisa Robinson Assistant Counsel Attachment no. 1 (in .pdf format) 3 The IRS has stated that it would like to receive comments from the public about specific types of transactions that should be exempted from the disclosure and list maintenance requirements.
