Listed Transactions and Tax Shelters

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I. Introduction

A. Tension between “tax planning” (good) and “tax shelters” or “tax avoidance” (considered bad, especially in the current political climate).

B. Judge Learned Hand – a taxpayer “may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.” Helvering v. Gregory, 69 F.2d 809, 810 (2nd Cir. 1934), affd. 293 U.S. 465 (1935).

C. Contrast – fast forward to the 21st Century:

2. Dept. of Justice issues summonses to “Fat Five” (now the “Final Four”?) regarding tax shelter investor lists, other shelter-related information.
3. Leaders of both Senate (Baucus, Democrat – S.2498) and House (Thomas, Repub. – H.R. 5095) introduce bills presumptively nullifying tax benefits for transactions without provable economic substance.
4. IRS and Treasury issue regulations expanding “corporate tax shelter” disclosure and related requirements to all taxpayers.
5. In short window “limited amnesty” program in late 2001, substantial tax shelter involvement (over 1,600 previously undisclosed transactions and over 1,000 participating taxpayers) was voluntarily disclosed to IRS, leading to a “round up” of other promoters and investors.
6. The Regulations on tax shelter disclosure are on their 5th revision since February 2000 – this is a rapidly evolving area.

D. Conclusions:

1. Pendulum swing was inevitable – 1998 “Witch Hunt” as part of IRS Restructuring painted IRS as evil and made tax compliance extremely unfashionable

2. What’s hot and what’s not:
   a. What’s hot (i.e., people involved in these are having more fun):
      i. Law and order
      ii. Disclosure
      iii. Expansion of Government’s power in numerous areas
   
   b. What’s not (i.e., people involved in these are more nervous):
      i. Tax shelters

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ii. Shelter promoters
iii. Confidentiality and privilege
iv. Shelter legal opinions (more difficult, but may be more needed)
II. Legislative Background

A. “General” or “traditional” Code sections of relevance:

1. Section 269
   a. IRS/Treasury can disallow tax benefits from certain transactions if principal purpose was evading or avoiding Federal income taxes.
   b. Application limited to certain transactions (generally involving acquisition of control of a corporation or of its property where basis is determined by reference to basis of transferor).

2. Section 446 – IRS/Treasury can force a taxpayer to change its method of accounting if the IRS determines it does not clearly reflect income. Potentially relevant in tax shelters where deferral of income or acceleration of deductions or basis recovery is involved.

3. Section 482 – IRS/Treasury can distribute, apportion, or allocate tax consequences between two or more entities which are controlled directly or indirectly by the same interests. Recently, IRS has adopted a broad interpretation of what this includes – acting in concert to avoid taxes may cause two unrelated entities to be considered part of the same controlled group. See Regs. 1.482-1(i)(4).

4. Section 7701(i)
   a. Provides IRS with authority to address tax shelter arrangements involving financing transactions.
   b. IRS has proposed regulations on lease stripping transactions
   c. Final regulations have been issued on:
      i. Step-down or fast-pay preferred stock;
      ii. Certain conduit financing arrangements.

B. Listed Transactions, Tax Shelter Registration and Related Provisions

1. Section 6011 – General Requirement of Filing Returns
   a. Note – this is one of the main sections that tax protestors ignore/deny.
   b. More importantly, it provides the IRS with the broad ability to request whatever information it feels is needed to obtain the information needed to enforce Federal tax laws.
2. Section 6111 – Tax Shelter Registration

a. Section 6111(a)(1) -- Tax shelter organizers must register perRegs. no later than the day on which the first offering for sale of investment interests occurs.

b. Section 6111(b)(2) – Investors claiming deductions from the shelter must include tax shelter identification number on their returns.

c. Section 6111(c) – Definition of “tax shelter” for purposes of registration requirement. Generally, a “tax shelter” is defined as an investment offering deductions and credits above a stated “tax shelter ratio”. Various interrelated definitions come into play, and are discussed later in this outline.

d. Section 6111(d) – Confidential arrangements are treated as a tax shelter if:
   i. A significant purpose of the structure is the avoidance of Federal income tax;
   ii. for a direct or indirect participant which is a corporation; and
   iii. for which the tax shelter promoters may receive fees over $100,000 in the aggregate.

e. Section 6111(d)(3) – Foreign-promoted shelters – U.S. participants become subject to the registration requirements (since IRS lacks jurisdiction to require registration by the foreign promoter).

f. “Promoter” is defined as any person or related person who participates in the organization, management or sale of the tax shelter.


a. Section 6112(a) – Any person who organizes or sells any interest in a “potentially abusive tax shelter” (PATS) must maintain a list identifying each person who was sold an interest in the shelter as detailed in the Regs.

b. Section 6112(b) – PATS defined as either:
   i. Any tax shelter under sec. 6111 (i.e., where registration is required); or
   ii. “Any entity, investment plan or arrangement, or other plan or arrangement which is of a type which the Secretary determines by Regulations as having a potential for tax avoidance or evasion.”

c. Section 6112(c)(1) – List must be retained for 7 years, and be provided to the IRS on request.