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# Impact Of American Jobs Creation Act, *Long Term Capital Holdings*, *Black & Decker*, *Coltec*, *TIFD III-E* and Other Tax Shelter Developments


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Procedural Tax Shelter Provisions of AJCA ’04

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

- **Penalty for failing to disclose a "reportable" transaction (new section 6707A)**
  - Amount of the penalty:
    - $10,000/$50,000 for "reportable" transactions
    - $100,000/$200,000 for "listed" transactions
  - Treasury is given the authority to define what constitutes a "reportable" transaction and a "listed" transaction in regulations under section 6011
  - The penalty cannot be waived for failing to report a "listed" transaction

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

- **Penalty for failing to disclose a "reportable" transaction (new section 6707A), continued**
  - The conference agreement notes that the penalty can be waived for failing to disclose a "reportable" transaction (other than a listed transaction) but only if:
    - The non-disclosing person has a history of complying with the tax laws
    - The violation is due to an unintentional mistake of fact and
    - Imposing the penalty would be against "equity and good conscience"
  - Applies regardless of whether transaction results in an understatement of tax
  - Applies in addition to any accuracy related penalties
  - A publicly traded entity required to pay this penalty for failing to disclose a "listed" transaction must disclose the imposition of the penalty in a filing with the SEC (regardless of whether the amount of the penalty is "material" for SEC purposes)
  - Effective date: Taxable years ending after the date of enactment

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

- **Reportable Transactions**
  - Defined in Treas. Reg. § 1.6011-4
  - Six categories of “reportable” transactions
    - Listed Transactions
    - Confidential Transactions
    - Transactions with tax benefit loss protection
    - Significant loss generators
    - Transactions with significant tax-book differences
    - Transactions involving a brief asset holding period

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

## LISTED TRANSACTIONS

- **Notice 2004-31** – Intercompany Financing Through Partnerships
- **Notice 2004-30** – S Corporation Tax Shelter Involving Shifting Income to Tax Exempt Organization
- **Notice 2004-20** – Abusive Foreign Tax Credit Transactions
- **Revenue Ruling 2004-20** – Abusive Transactions Involving Insurance Policies in IRC 412(i) Retirement Plans
- **Revenue Ruling 2004-04** – Prohibited Allocations of Securities in an S Corporation
- **Notice 2004-8** – Abusive Roth IRA Transactions
- **Notice 2003-81** – Offsetting Foreign Currency Option Contracts
- **Notice 2003-77** – Improper use of contested liability trusts to attempt to accelerate deductions for contested liabilities under IRC 461(f)
- **Notice 2003-55** – Accounting for Lease Strips and Other Stripping Transactions
- **Notice 2003-47** – Transfers of Compensatory Stock Options to Related Persons
- **Notice 2003-24** – Certain Trust Arrangements Seeking to Qualify for Exception for Collectively Bargained Welfare Benefit Funds under § 419A(f)(5)
- **Notice 2003-22** – Offshore Deferred Compensation Arrangements
- **Revenue Ruling 2003-6** – Abuses Associated with S Corp ESOPs
- **Revenue Ruling 2002-69** – Lease In / Lease Out or LILO Transactions
- **Notice 2002-50** – Partnership Straddle Tax Shelter
- **Notice 2002-35** – Notional Principal Contracts
- **Notice 2002-21** – Inflated Basis "CARDS" Transactions
- **Notice 2001-45** – §302 Basis-Shifting Transactions
- **Notice 2001-17** – Contingent Liability Transactions
- **Notice 2001-16 –** Intermediary Transactions
- **Notice 2000-61 –** Guam Trust
- **Notice 2000-60** – Stock Compensation Transactions
- **Notice 2000-44** – Inflated Partnership Basis Transactions
- **Revenue Ruling 2000-12** – Debt Straddles
- **Treasury Regulation § 1.7701(l)-3** – Fast Pay or Step-Down Preferred Transactions
- **Notice 99-59** – BOSS Transactions
- **Treasury Regulation § 1.643(a)-8** – Certain Distributions from Charitable Remainder Trusts
- ***ASA Investerings Partnership v. Commissioner*** -Transactions similar to that described in the ASA Investering litigation and in *ACM Partnership v. Commissioner*, 157 F.3d 231 (3rd Cir. 1998)
- **Notice 95-34** – Certain Trusts Purported to be Multiple Employer Welfare Funds Exempted from the Lists of §§ 419 and 419A
- **Revenue Ruling 90-105** – Certain Accelerated Deductions for Contributions to a Qualified Cash or Deferred Arrangement or Matching Contributions to a Defined Contribution Plan

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

- **“Angel List” Of Losses That Are Not Reportable Transactions (Rev. Proc. 2003-24)**
  - Casualty losses
  - Losses from a compulsory or involuntary conversion
  - A loss arising from any mark-to-market treatment of any item, provided that the taxpayer computes its loss:
    - by using a qualifying basis,
    - by using a basis resulting from previously marking the item to market, or
    - by making appropriate adjustments for previously determined mark-to-market gain or loss
  - A loss described from a hedging transaction described in section 1221(b) or from a mixed straddle account
  - A loss attributable to basis increases under section 860C(d)(1)
  - A loss attributable to the abandonment of depreciable tangible property that was used by the taxpayer in a trade or business and that has a qualifying basis
  - A loss arising from the bulk sale of inventory if the basis is determined under section 263A
  - A loss that is equal to, and determined solely by reference to, a payment of cash by the taxpayer.

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

“Angel List” of Book-Tax Differences That Are Not Reportable Transactions
(Rev. Proc. 2003-25)

- Book loss claimed before or without tax loss
- Tax income claimed before or without book income
- Depreciation differences relating solely to lives, methods or conventions
- Percentage depletion and deductible drilling costs
- Capitalization and amortization under sections 195, 248, and 709
- Bad debt and cancellation of indebtedness income
- Federal, state, local, or foreign taxes
- Compensation amounts, including options, pensions
- Charitable contributions of cash or tangible property
- Tax exempt interest
- Dividends, including dividends received deductions, amounts treated as dividends under section 78, distributions of previously taxed income, and income inclusions under sections 551, 951, and 1293
- A dividends paid deduction by a publicly-traded REIT
- Patronage refunds or dividends of cooperatives
- Items resulting from the application of section 1033
- Items resulting from the application of sections 354, 355, 361, 367, 368, or 1031, if the taxpayer complies with the filing and reporting requirements for these sections
- Items resulting from debt-for-debt exchanges
- Items resulting solely from the treatment as a sale, purchase, or lease for book purposes and as a financing for tax purposes
- Treatment of a transaction as a sale for book purposes and as a nontaxable transaction under section 860F(b)(1)(A) for tax purposes
- Items resulting from differences solely due to the use of hedge accounting for book purposes and not for tax purposes, or vice versa
- Items resulting solely from the use of the mark-to-market method of accounting for book purposes and not for tax purposes, or vice versa
- Items resulting from the application of section 1286
- Inside buildup, death benefits, or cash surrender value of life insurance or annuity contracts
- Life insurance reserves determined under section 807 and non-life insurance reserves determined under section 832(b)
- Capitalization of policy acquisition expenses of insurance companies
- Imputed interest income or deductions
- Gains and losses arising under sections 986(c), 987, and 988
- Items excluded under section 883, section 921, or an applicable treaty from a foreign corporation’s income that would be otherwise subject to tax under section 882.
- Section 481 adjustments
- Inventory valuation differences, whether attributable to LIFO computations or obsolescence reserves
- Section 198 deductions for environmental remediation costs

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

- **Two-tier accuracy related penalty for a reportable transaction (new section 6662A of the Code)**
  - **A new accuracy-related penalty**
  - **Applies to reportable and listed transactions**
  - **Penalty rates**
    - A 20% accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed or reportable avoidance transaction
    - A 30% accuracy-related penalty is imposed on any understatement attributable to a listed or reportable avoidance transaction that is <u>not</u> adequately disclosed
      - The 30% penalty cannot be waived under the reasonable cause exception (described below)
  - **Calculation of the Understatement**
    - An understatement is the sum of:
      - The product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the proper treatment of the item and
      - The amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

- **Two-tier accuracy related penalty for a reportable transaction (new section 6662A of the Code), continued**
  - The 20% penalty can be waived for reasonable cause (the "strengthened reasonable cause exception"), which exists only if it is shown that there was reasonable cause for the understatement and the taxpayer acted in good faith
  - Such a showing requires:
    - Adequate disclosure (in accordance with the section 6011 regulations) of the transaction
    - That there is or was substantial authority for the taxpayer's position <u>and</u>
    - That the taxpayer reasonably believed that its position was more likely than not the correct position
  - A taxpayer will be treated as having a "reasonable belief" only if such belief:
    - Is based on the facts and law that exist at the time of the tax return and
    - Relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that
      - A return will not be audited
      - The treatment will not be raised on audit or
      - The treatment will be resolved through settlement if raised on audit

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

- **Two-tier accuracy related penalty for a reportable transaction (new section 6662A of the Code), continued**
  - A taxpayer may rely on an opinion of a tax advisor in establishing its belief, but a taxpayer may not rely on an opinion of a tax advisor if the opinion
    - Is provided by a "disqualified tax advisor" or
    - Is a "disqualified opinion"
  - A "disqualified tax advisor" is any advisor who
    - Is a material advisor (as that term is defined under section 6111)
    - Is compensated directly or indirectly by a material advisor with respect to the transaction
    - Has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained or
    - Has a "disqualifying financial interest" with respect to the transaction, as determined by regulations
  - A "disqualified opinion" is an opinion that
    - Is based on "unreasonable factual or legal assumptions"
    - "Unreasonably relies" upon representations, statements, findings or agreements of the taxpayer or any person,
    - Does not identify and consider all relevant facts, or
    - Fails to meet any other requirements prescribed by Treasury

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Taxpayers)

- **Two-tier accuracy related penalty for a reportable transaction (new section 6662A of the Code), continued**
  - Coordination with other penalties
    - Any understatement upon which this penalty is imposed is not subject to the accuracy related penalty under section 6662
    - Any understatement upon which this penalty is imposed is included for purposes of determining whether any understatement is a "substantial understatement" under section 6662
    - Any understatement upon which this penalty is imposed is not subject to the valuation misstatement penalties under sections 6662(e) or 6662(h)
    - This accuracy related penalty shall not apply to any portion of an understatement to which a fraud penalty under section 6663 applies
  - A publicly traded entity may be required to disclose the imposition of this penalty in a filing with the SEC (regardless of whether the amount of the penalty is "material" for SEC purposes)
  - Effective date: Taxable years ending after the date of enactment

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Promoters)

- **Penalty on Promoters of Tax Shelters (amendments to section 6700 of the Code)**
  - Increase in the promoter penalty from $1,000 to 50% of the gross income derived from the tax shelter
- **Disclosure of Reportable Transactions**
  - "Material Advisors" are required to disclose reportable transactions on an information return prescribed by Treasury
  - Failure to timely file the information return results in a penalty
    - Reportable transactions (other than listed transactions): $50,000
    - Listed transactions: the greater of $200,000 or 50% of the material advisor's gross income derived from the transaction before the due date of the information return—intentional disregard results in a penalty increase of 75% of the material advisor's gross income
  - A "Material Advisor" is anyone who:
    - Provides material aid, assistance, or advice with respect to insuring, organizing, promoting, selling, implementing, or carrying out any reportable transaction and
    - Directly or indirectly derives more than $250,000 in gross income from providing such assistance or advice ($50,000 if substantially all of the tax benefits of the reportable transaction are provided to natural persons)

# Tax Shelter Provisions—Tighten Reporting and Penalty Rules (Promoters)

- **Investor Lists**
  - Material Advisors are required to maintain investor lists with respect to reportable transactions
  - A material advisor who fails to make its investor list available to the IRS within 20 days of receiving a written request to do so is subject to a $10,000/day penalty
- **Confidentiality**
  - Communications with respect to tax shelters are not subject to the confidentiality protections that otherwise apply to a communication between a taxpayer and a federally authorized tax practitioner

# Other Selected Anti-Abuse Rules

- **Substantial Understatement Penalty**
  - The definition of "substantial" as it applies to corporate taxpayers for purposes of section 6662 is amended so that a corporate taxpayer has a substantial understatement if the amount of the understatement exceeds the lesser of
    - 10% of the tax required to be shown on the return for the taxable year or
    - $10 million
- **Other targeted proposals**
  - Inversions
    - Inversions involving 80% identity of stock ownership are disregarded
    - Inversions involving 50% identity of stock ownership are respected but any applicable corporate-level "toll charges" or corporate level income or gain as a result of the inversion transaction cannot be offset by NOLs, FTCs, or other corporate tax attributes
  - SILO provisions
  - Elimination of the FASIT regime
  - Elimination of the related party requirement in the interest disallowance rules for convertible debt
- **Not enacted**
  - Codification of the "Economic Substance Doctrine"
  - CEO tax return signature requirement
  - "Super 269"

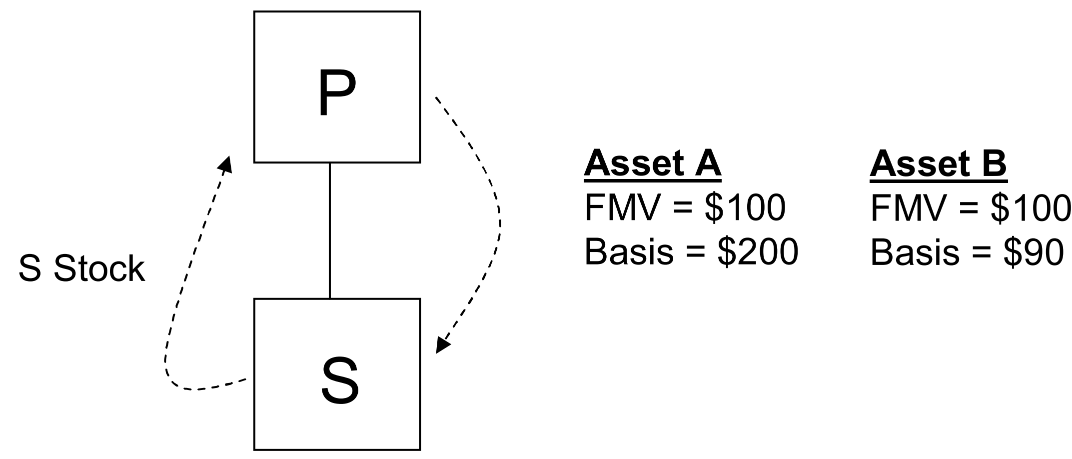
Targeted Transactional Tax Shelter Provisions of AJCA ‘04

# Limitation on Transfer of Built-in Losses—Overview

- **Section 362 Prior to AJCA: Section 351 Transactions (Other than Loss Importation Transactions Discussed Below)**
  - Under section 358, the transferor's basis in the stock of the controlled corporation was the same as the basis of the property contributed to the controlled corporation, increased by the amount of any gain (or dividend) recognized by the transferor on the exchange, and reduced by the amount of any money or property received, and by the amount of any loss recognized by the transferor
  - Under section 362, the corporation's basis in the transferred property was the same as it would have been in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer

- **Section 362 as Amended by AJCA: Section 362(e)(2)—Transfer of losses in a Section 351 Transaction**
  - If the aggregate adjusted basis of property contributed by a transferor (or by a control group of which the transferor is a member) to a corporation exceeds the aggregate fair market value of the property transferred:
    - The transferee's aggregate basis in the properties is limited to the aggregate fair market value of the transferred property
    - Any required basis reduction is allocated among the transferred properties in proportion to their built-in-loss immediately before the transaction
    - Transferor and transferee may elect to limit the basis in the stock received by the transferor to the aggregate fair market value of the transferred property, in lieu of limiting the basis in the assets transferred
      - Such election shall be included with the tax returns of the transferor and transferee for the taxable year in which the transaction occurs and, once made, shall be irrevocable

# Limitation on Transfer of Built-in Losses—Example




**Facts**: P contributes: (i) Asset A with a fair market value of $100 and an adjusted basis of $200 and (ii) Asset B with a fair market value of $100 and a basis of $90 to S in exchange for S stock in a section 351 exchange.

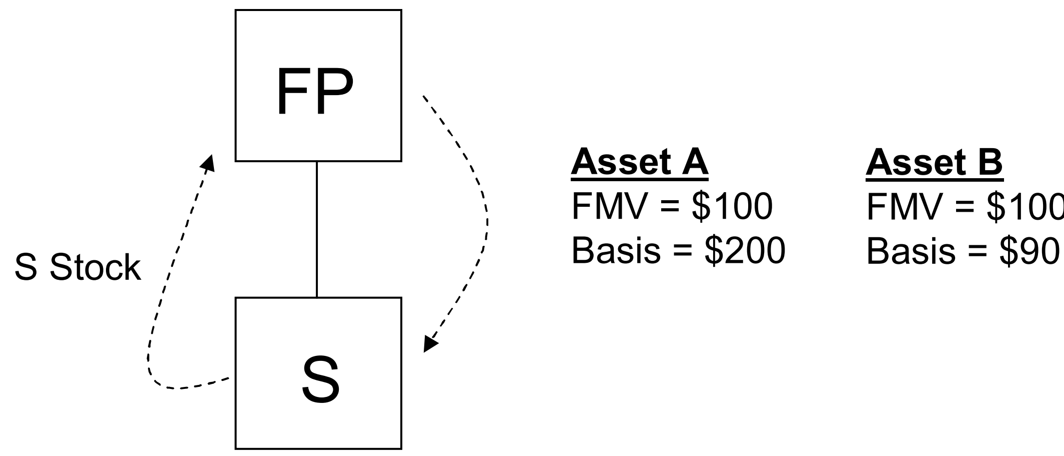
**Analysis**: Unless P and S elect otherwise, P's basis in its S shares is $290. There is an aggregate built-in loss of $90 in Assets A and B. Thus, under new § 362(e)(2) S's aggregate basis in Assets A and B equals $200 (i.e., the aggregate fair market value of Assets A and B). S's basis in Asset A is reduced to $110 [200 – ($90 x $90/$90)] (i.e., the proportionate share of built-in loss allocable to Asset A). S's basis in Asset B remains $90 [$90 – ($90 x $0/90]. See section 362(e)(2).

# Limitation on Importation of Built-in Losses—Overview

- **Section 362 Prior to AJCA: Incorporations, Reorganizations and Liquidations**
  - The basis of property received by a corporation, whether from domestic or foreign transferors, in a tax-free incorporation, reorganization, or liquidation of a subsidiary corporation was the same as the adjusted basis in the hands of the transferor, adjusted for gain or loss recognized by the transferor

- **Section 362 as Amended by AJCA: Section 362(e)(1)—Importation of Losses (Incorporations, Reorganizations and Liquidations)**
  - If a "net built-in loss" is imported into the U.S in a tax-free incorporation or reorganization from persons not subject to U.S. tax, the basis of each property so transferred is its fair market value
    - A "net built-in loss" is treated as imported into the U.S. if the aggregate adjusted bases of property received by a transferee corporation exceed the fair market value of the properties transferred
  - Similar rules apply in the case of the tax-free liquidation by a domestic corporation of its foreign subsidiary

# Limitation on Importation of Built-in Losses—Example




**Facts**: FP, a non-U.S. corporation not subject to U.S. taxation, incorporates S, a U.S. corporation. FP contributes to S: (i) Asset A with a fair market value of $100 and an adjusted basis of $200 and (ii) Asset B with a fair market value of $100 and a basis of $90 in exchange for S stock in a section 351 exchange. Immediately before the contribution, FP's gain or loss with respect to Assets A and B is not subject to U.S. taxation.

**Analysis**: FP's basis in its S shares is $290. Although this transaction is subject to the rules of sections 362(e)(1) and (e)(2), the loss importation rules of section 362(e)(1) have priority. See section 362(e)(2)(A)(i). Thus, S's basis in Asset A is reduced to $100 and S's basis in Asset B is increased to $100. See section 362(e)(1).

# Partnership Provisions

- **Transfers of Partnership Interests Prior to AJCA (Section 743)**
  - A partnership did not adjust the basis of partnership property following the transfer of a partnership interest unless the partnership has made a section 754 election.
  - If an election was in effect, adjustments were made with respect to the transferee partner to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee's basis in its partnership interest. These adjustments were intended to adjust the basis of partnership property to approximate the result of a direct purchase of the property by the transferee partner.
  - Under these rules, if a partner purchased an interest in a partnership with an existing built-in loss and no election under section 754 was in effect, the transferee partner could have been allocated a share of the loss when the partnership disposed of the property (or depreciated the property)

- **Distributions of Partnership Property Prior to AJCA (Section 734)**
  - Adjustments to the basis of the partnership's undistributed properties were not required unless the partnership had made a section 754 election. If a section 754 election was in effect, adjustments were made by a partnership to increase or decrease the basis of the remaining partnership assets to reflect any increase or decrease in the adjusted basis of the distributed properties in the hands of the distributee partner (or gain or loss recognized by the distributee partner)
  - To the extent the adjusted basis of the distributed properties increased (or loss was recognized) the partnership's adjusted basis in its properties was decreased by a like amount; likewise, to the extent the adjusted basis of the distributed properties decrease (or gain was recognized), the partnership's adjusted basis in its properties was increased by a like amount
  - Under these rules, a partnership with no election in effect under section 754 could distribute property with an adjusted basis lower than the distributee partner's proportionate share of the adjusted basis of all partnership property and leave the remaining partners with a smaller net built-in gain or a larger net built-in loss than before the distribution

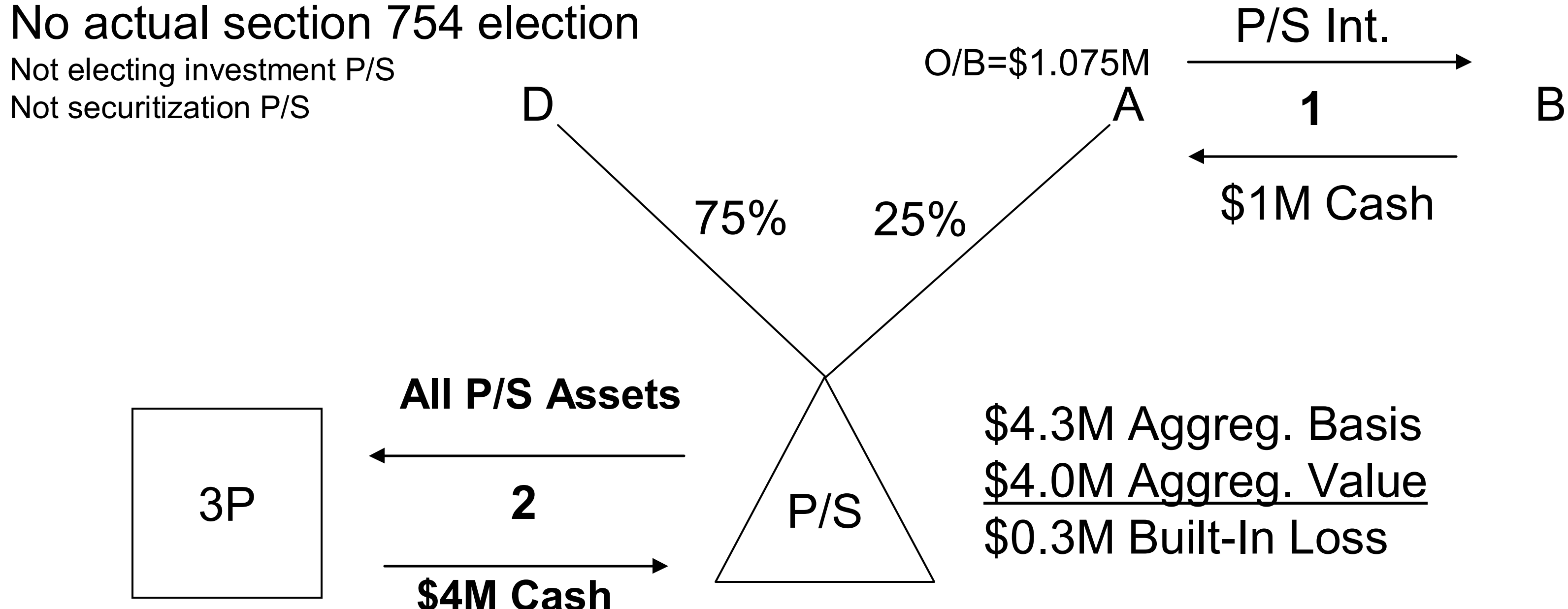
# Partnership Provisions—Loss Transfer and Basis Adjustment Rules As Amended by AJCA

- Contributions of Property (Section 704(c) as amended by AJCA)
  - In general, built-in losses in contributed property are to be taken into account only by the contributing partner
  - In determining the amount of items allocated to partners other than the contributing partner, the basis of contributed built-in loss property is treated as the fair market value at the time of contribution
    - Thus, if the contributing partner’s partnership interest is transferred or liquidated, the partnership’s adjusted basis in the built-in loss property is based on its fair market value at the time of contribution, and the built-in loss is eliminated
- Transfers of Partnership Interests (Section 743 as amended by AJCA)
  - Basis adjustments under section 743 are generally required in the case of the transfer of a partnership interest with respect to which there is a “substantial” built-in loss (rather than being elective)
    - A “substantial” built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property

# Partnership Provisions—Loss Transfer and Basis Adjustment Rules As Amended by AJCA

- **Distributions of Partnership Property (Section 734 as Amended by AJCA)**
  - Basis adjustment under section 734(b) is generally required in the case of a distribution with respect to which there is a “substantial” basis reduction
    - A “substantial” basis reduction means a downward adjustment of more than $250,000 that would be made to the basis of partnership assets if a section 754 election were in effect
- Exceptions are provided in amended sections 743 and 734 for “securitization partnerships” and in section 743 for “electing investment partnerships"

# Partnership Provisions—Section 743 Example

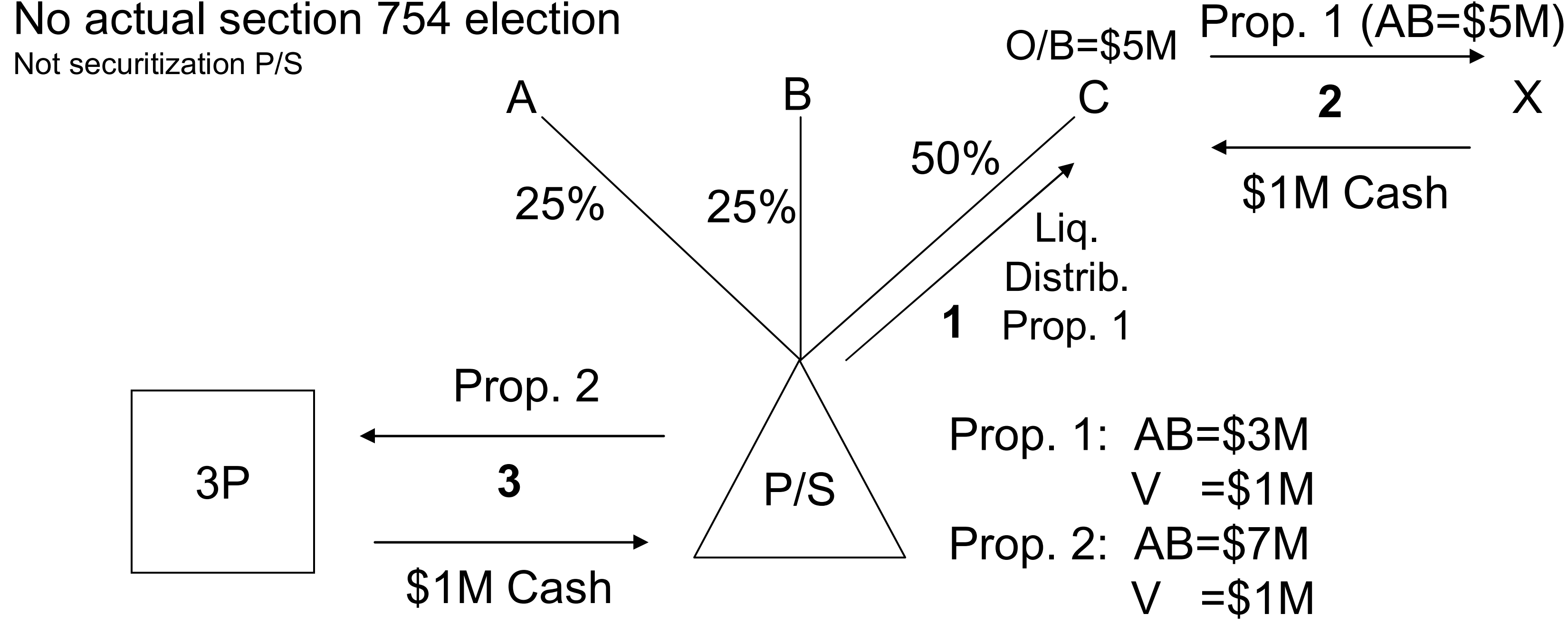



**Analysis**: Before the transaction, there is $300,000 of built-in loss in P/S assets. Under previous law, without a section 754 election, this transaction would have permitted D, A, and B to recognize $375,000 of built-in loss. Under new law, although there is no section 754 election, section 743(b) applies with respect to B so that B does not benefit from A's 25% share of the $300,000 built-in loss in P/S assets recognized upon the sale of those asset to 3P, thereby decreasing total built-in loss recognized by D, A, and B to $300,000 (D recognizes a loss of $225,000 (75% of the built-in loss), A recognizes a loss of $75,000 (25% of the built-in loss), and B does not recognize a gain or loss). See 743(b)(2); Treas. Reg. § 1.743-1(j)(1).

# Partnership Provisions—Section 734 Example

No actual section 754 election

Not securitization P/S




**Analysis**: Before the transaction, there is $8 million of built-in loss in P/S assets. Under previous law, without a section 754 election, the total built-in loss recognized by A, B, and C would have been $10 million. Under new law, although there is no section 754 election, section 734(b) applies so as to decrease the adjusted basis of Prop. 2 by $2 million at step 1, thereby decreasing the total built-in loss recognized by A, B, and C to $8 million. See section 734(b)(2)(B).



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# Other Selected Partnership Provisions

- **No reduction of basis under section 734 in stock of corporate partner held by partnership**
  - In applying the basis allocation rules to a distribution in liquidation of a partner's interest, a partnership is precluded from decreasing the basis of corporate stock of a partner or a related person
  - Any decrease in basis that, absent the provision, would have been allocated to the stock is allocated to other partnership assets
  - If the decrease in basis exceeds the basis of the other partnership assets, then gain is recognized by the partnership in the amount of the excess

- **Recognition of COD income realized on the satisfaction of debt with a partnership interest**
  - Section 108(e)(8) is expanded to include partnership interests
  - If a partnership transfers a capital or profits interest to a creditor to satisfy partnership debt, the partnership will recognize COD income equal to the excess of the partnership's debt over the fair market value of the partnership interest used to satisfy the debt

# Targeted International Transactional Provisions of AJCA '04

- SILOs
- Corporate Expatriation
- Individual Expatriation
- Minimum Holding Period for Foreign Tax Credits
- Reversal of *The Limited*
- Mismatching of interest/OID deductions and income
- Liquidation of new holding companies
- Expansion of ECI
- Recapture of OFL on sale of CFC
- Basis of NRAs in annuity and life insurance contracts
- "Guam Trusts": residence and source rules involving possessions

## *Gregory*:

## Its Provenance and Its Progeny

# *Gregory*: Its Provenance and Its Progeny

- *Gregory v. Helvering*, 293 U.S. 465 (1935)
  - Countless forms of authority cite *Gregory* as the foundation for the application of a business purpose requirement to all types of transactions.
  - In *Gregory*, there was no business purpose.
  - The Supreme Court and Circuit Court opinions do not say that the business purpose must predominate, must be the primary purpose, or must be even a substantial purpose.
    - The Second Circuit suggested that the reorganization must be actuated by a purpose that is more than just "an ephemeral incident" to the "conduct of the venture in hand."
    - The Supreme Court suggested that the reorganization must be actuated by a purpose that has something more than "no relation to the business of either" the transferor or transferee corporation.
  - Subsequent Courts have not limited *Gregory* to cases in which there is no business purpose

# Issues for Analysis

- Is there a business purpose requirement for all transactions?
  - Sales
  - Financings
  - Check-the-box
  - Organization of S corps, partnerships
  - Choice of debt or equity
  - Specifically legislated consequences
- What is the scope of the transaction being analyzed?
  - The overall transaction, or
  - The manner of execution (and component steps)

# Issues for Analysis

- How much business purpose is enough?
- Significance of related party transactions
  - Business purpose only an issue when a reorganization occurs between related parties?
- What if only one party has a business purpose?
- Shareholder v. corporate business purpose in reorganizations
  - Unclear whether a valid shareholder-level business purpose alone (rather than a corporate-level business purpose) will suffice

# Issues for Analysis

- Distinguishing among anti-abuse rules and doctrines
  - Common law doctrines
    - Economic Substance/Economic Sham
    - Business purpose doctrine
    - Factual Sham
    - Step Transaction
    - Assignment of Income
    - Clear Reflection of Income
    - Substance Over Form
    - Court Holding/Est. of Kluener
    - Waterman Steamship/Esmark

# Economic Substance Case Law: Supreme Court

- *Gregory v. Helvering* (1935)
  - "That which the statute intended"
    - Famous quotes in tension:
      - "Anyone may arrange his affairs . . ."
      - "Like a melody is more than the sum of the notes . . ."
- *Knetsch v. United States* (1960), see also *Goldstein* (2nd Cir. 1966)
  - Prepaid interest: Circular vs. 3d party
- *Frank Lyon Co. v. United States* (1978)
  - Why tax-motivated leasing is not a "bad" tax shelter
- *United States v. Consumer Life Insurance Co.* (1977)
  - Reinsurance agreements respected under *Gregory* and *Knetsch*; suggests having business purpose or economic substance is sufficient
- *Cottage Savings Ass'n v. Commissioner* (1991)
  - Loss on exchange of mortgages respected
  - Technical analysis, not anti-abuse case (neither *Gregory* nor *Frank Lyon* cited in majority opinion (although *Gregory* cited in lower court));
  - Dissenter in *Frank Lyon* agrees (Stevens); author of *Frank Lyon* dissents (Blackmun)

# Economic Substance Case Law: Other Important Cases

- *Glass v. CIR* (TC 1986), *Rice's Toyota World, Inc. v. CIR*. (4th Cir. 1985), *Est. of Franklin v. CIR* (9th Cir. 1976)
  - Factual shams?
- *Sheldon v. CIR* (TC 1990)
  - A peppercorn of profit is not enough
- *UPS* (11th Cir. 2001)
  - Right answer, wrong reason; or vice versa?
- *Compaq/IES* (5th Cir. 2001)
  - Wrong answer, wrong reason?
- *ACM, et al.* (3d Cir. 1998)
  - The most recent circuit court standards?
  - Same transaction, different lower court results (different facts adduced at trial?)
- *Long-Term Capital Holdings v. United States*, (D. Conn. Aug. 27, 2004)
  - A recent and scathing pronouncement
  - Penalties despite an opinion
- *Black & Decker*; *Coltec*
  - Following *Gitlitz* into literalism?
  - Potentially reading economic substance out of the law
- *TIFD III-E*
  - Same court as *LTCH*, very different result

The Most Recent Case Law:

*LTCH*,

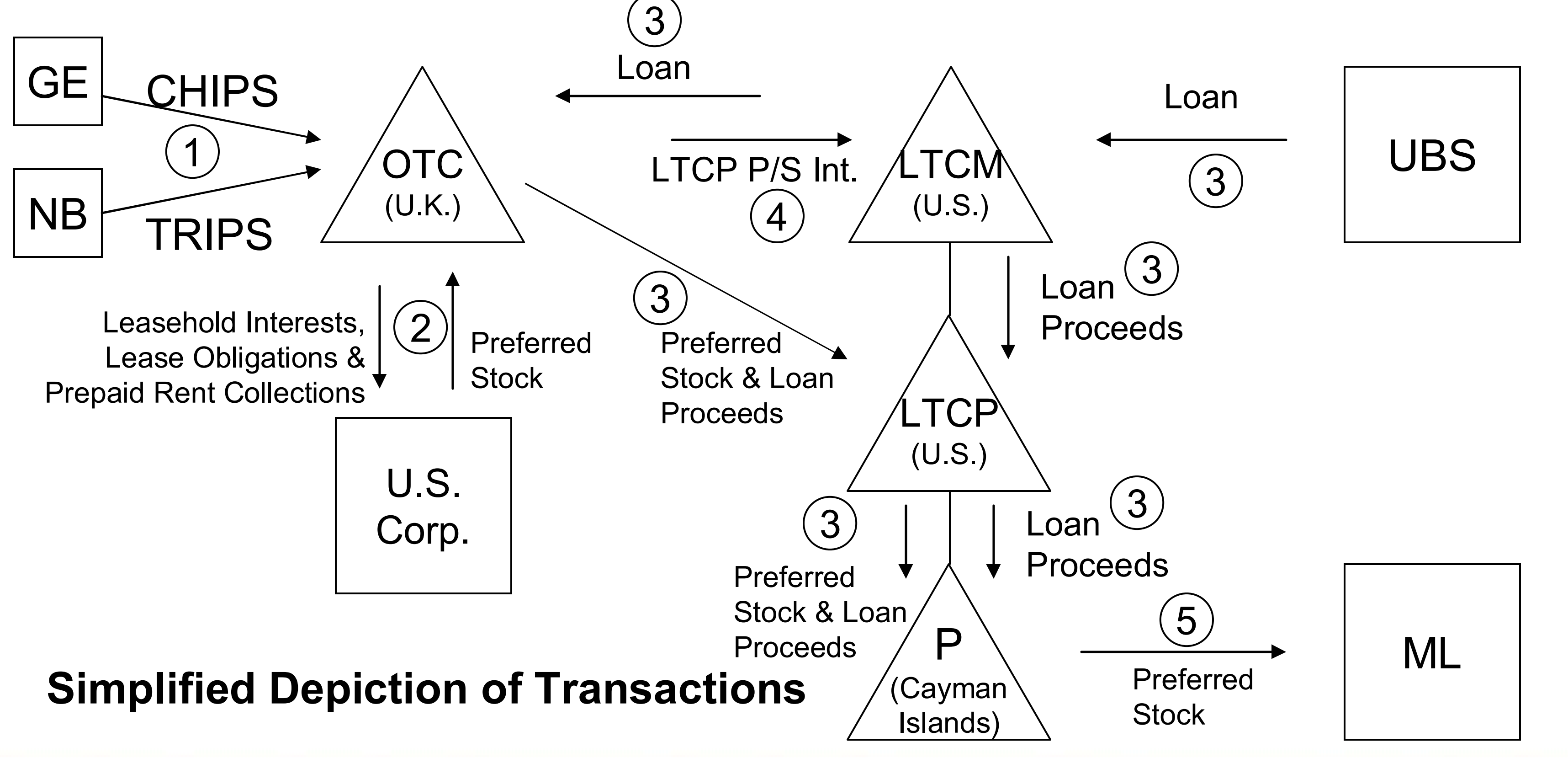
*Black & Decker*,

*Coltec*,

*TIFD III-E*

# The Most Recent Case Law: Long Term Capital Holdings

- ***Long-Term Capital Holdings v. United States*, 2004 WL 1924931 (D. Conn. Aug. 27, 2004)**




**Simplified Depiction of Transactions**

# The Most Recent Case Law: Long Term Capital Holdings

- *Long-Term Capital Holdings v. United States*, 2004 WL 1924931(D. Conn. Aug. 27, 2004)
  - Overall, the transactions permitted U.S. taxpayers to enjoy a tax loss without incurring an economic loss.
    - First, OTC engaged in CHIPS and TRIPS transactions (i.e., lease stripping transactions involving computers and tractors). The transactions involved OTC receiving tax-free prepayments of rent, which it had a future obligation to pay to a third party under a lease.
    - Second, OTC contributed its leasehold interests, the lease payment obligations, and the prepaid rent collections to U.S. corporations in exchange for preferred stock, thereby purportedly giving the preferred stock a high basis (due to the contributed rent collections) and low value (due to the contributed lease payment obligations).
    - Third, the following transactions effectively occurred during the same time period.
      - An entity controlled by the same owners of LTCM made a loan to OTC.
      - UBS made a separate loan to LTCM.
      - LTCM contributed the loan proceeds to LTCP.
      - OTC contributed preferred stock (and the proceeds from its loan) to LTCP in exchange for a partnership interest in LTCP.
      - LTCP contributed the preferred stock (and the proceeds from both loans) to P, a hedge fund.
    - Fourth, OTC sold its partnership interest to LTCM via the exercise of a put option.
    - Fifth, P sold the preferred stock for cash to ML, thereby triggering the built-in loss.
      - The built-in loss flowed up through LTCP and LTCM and was taken into account by LTCM partners for their 1997 tax years.
      - Section 704(c) allocation of built-in loss to OTC was avoided by sale of OTC’s partnership interest to LTCM just prior to the sale of the preferred stock by P.

# The Most Recent Case Law: Long Term Capital Holdings

- *Long-Term Capital Holdings v. United States*, 2004 WL 1924931 (D. Conn. Aug. 27, 2004)
  - Court focused only on the third, fourth, and fifth steps of the overall transaction.
  - Court held that these subsequent steps should be disregarded under the economic substance doctrine.
    - Court rejected taxpayer's argument that the Second Circuit has clearly adopted a disjunctive test. The court applied a combination test.
      - Citing *Frank Lyon* as primary support, the court ruled: "The terminology used, whether sham, profit motivation, or economic substance, is not critical, rather the analysis evaluates both the subjective business purpose of the taxpayer for engaging in the transaction and the transaction's objective economic substance, and a finding of either a lack of a business purpose other than tax avoidance or an absence of economic substance beyond the creation of tax benefits can be but is not necessarily sufficient to conclude the transaction a sham."

# The Most Recent Case Law: Long Term Capital Holdings

- *Long-Term Capital Holdings v. United States*, 2004 WL 1924931 (D. Conn. Aug. 27, 2004)
  - Court found no reasonable expectation of profit.
    - Court found that several side agreements provided hidden fees to the parties structuring the transactions.
    - Court refused to broaden the "scope of the transaction" so that the taxpayer could appear to have a reasonable expectation of profit.
      - Refusing to consider the UBS loan transactions, the court stated: "[The taxpayer] cannot avoid the requirements of economic substance simply by coupling a routine economic transaction generating substantial profits and with no inherent tax benefits to a unique transaction that otherwise has no hope of turning a profit."
    - Not enough that the transactions caused changes in the economic positions/rights of the parties (other than tax savings).
      - The fact that OTC actually sold its partnership interest to LTCM for cash was not significant.

# The Most Recent Case Law: Long Term Capital Holdings

- *Long-Term Capital Holdings v. United States*, 2004 WL 1924931 (D. Conn. Aug. 27, 2004)
  - Court found no non-tax business purpose.
    - Purported primary business purpose of generating additional investment fees from the contribution of the preferred stock (and cash) to P was disingenuous, since
      - taking fee-generating investments was P's core business and it regularly did so without the complex machinations and millions in transaction costs that the present transactions had,
      - the transactions were brought to the taxpayer as a "tax product" rather than as an investment,
      - the proposals for the transactions were brought only to the taxpayer's Director of Taxes,
      - the initial meetings among the taxpayer and its advisors centered on the potential tax deductions available and structuring a transaction to pass muster under the economic substance doctrine,
      - the testimony of the taxpayer's owners indicated that they thought of the transaction as a tax transaction,
      - the taxpayer permitted OTC to make the contribution of preferred stock (and cash) in contravention of the taxpayer's investing requirements (i.e., OTC was the only outside investor that was ever permitted to contribute assets other than cash and OTC was the only foreign investor permitted to invest directly in the taxpayer), and
      - an internal memorandum of the taxpayer indicated that the taxpayer was determining how to compensate the individuals who "brought the tax losses to fruition" roughly one year before OTC sold its partnership interest via the put option to LTCM.

# The Most Recent Case Law: Long Term Capital Holdings

- *Long-Term Capital Holdings v. United States*, 2004 WL 1924931 (D. Conn. Aug. 27, 2004)
  - Court rejected taxpayer's argument that it met the business purpose requirement, as interpreted by UPS.
    - Court characterized interpretation of business purpose requirement in UPS as an "expansive view."
    - Court noted that the following characteristics distinguished the case from UPS:
      - the investment by OTC in the partnership represented a one-time purchase of a tax product,
      - the investment by OTC was different in almost every way from the taxpayer's core investment business, and
      - the transactions did not effect a mere change in the manner in which a profit making business was administered.
  - Court rejected the argument that, since OTC had no U.S. tax avoidance purpose, the transactions as a whole met the business purpose test. The court stated: "[A]doption of petitioners' position would require a finding of business purpose whenever a transaction involving one entity solely motivated by tax avoidance included a foreign entity lacking motivation to avoid U.S. taxes for which it is not liable."

# The Most Recent Case Law: Long Term Capital Holdings

- *Long-Term Capital Holdings v. United States*, 2004 WL 1924931 (D. Conn. Aug. 27, 2004)
  - Court upheld imposition of penalties, despite “long-form” legal opinion from King & Spalding.
    - Court stated that the legal opinion did not insulate taxpayer from penalties since
      - it was not received by the taxpayer until after the taxpayer filed the tax return that claimed the relevant tax benefits,
      - evidence of an earlier oral opinion was insufficient,
      - even if the written opinion had been received in time, the opinion included unreasonable factual assumptions (e.g., it was assumed that the taxpayer had a valid business purpose and reasonably expected to earn a material pre-tax profit), and
      - the opinion failed to discuss the precedent from the Circuit to which an appeal could be made.
    - Court described the written opinion as containing a “selective discussion of authority . . ., which bolsters its appearance as an advocacy piece not a balanced reasoned opinion with the objective of guiding a client’s decisions.”
    - Court also found significant the fact that the taxpayer tried to hide the loss on its tax return by combining lines of Schedule M-1, which caused the loss to be netted against other income.

# The Most Recent Case Law: Black & Decker Corporation

- *Black & Decker Corporation v. United States*, Case No. WDQ-02-2070 (D. Md. Oct. 22, 2004)
  - In a six-page opinion entered on October 22, 2004, the United States District Court for the District of Maryland granted summary judgment in favor of Black & Decker Corporation ("Black & Decker"), upholding the $560 million capital loss claimed by Black & Decker from the contingent liability transaction at issue in this tax refund litigation.
  - The transaction was structured in similar fashion to the "listed" transaction described by the IRS in Notice 2001-17.
  - The transaction involved the centralization of the management of the taxpayer's employee and retiree healthcare benefit plans in a separate subsidiary with the single focus of managing and administering the plans.
  - The transaction involved the following steps:
    - Black & Decker and certain of its subsidiaries exchanged cash of approximately $561 million for stock in a separate subsidiary, Black & Decker Healthcare Management, Inc. ("BDHMI"), and the assumption by BDHMI of certain employee and retiree healthcare liabilities with a value of $560 million.
    - Plaintiff and its subsidiaries later sold stock in BDHMI in an arm's length sale to an independent third-party for $1 million.
    - Plaintiff claimed a $560 million capital loss from the stock sale, taking the position that the cost basis of the shares was unreduced by the contingent liabilities assumed by BDHMI (this position was addressed by the Court in an earlier ruling on the government's motion for summary judgment).

# The Most Recent Case Law: Black & Decker Corporation

- *Black & Decker Corporation v. United States*, Case No. WDQ-02-2070 (D. Md. Oct. 22, 2004)
  - In reaching its decision, the District Court relied exclusively upon its application of the Fourth Circuit Court of Appeals' sham transaction doctrine to the transaction at issue. Under this doctrine, the tax results of a transaction may be disallowed if the court finds "that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, *and* that the transaction has no economic substance because no reasonable possibility of profit exists." *Rice's Toyota World v. Commissioner*, 752 F.2d 89, 90 (4th Cir. 1985) (emphasis added).
  - For purposes of its summary judgment motion, Black and Decker conceded that tax avoidance was its sole motivation for entering into the transaction at issue.
  - Despite this concession, the District Court applied the sham transaction test in disjunctive fashion, concluding that the tax benefits claimed by Black & Decker from the transaction should be allowed on the basis that the transaction had economic substance aside from its tax benefits.
  - In support of its analysis, the court reasoned that "a corporation and its transactions are objectively reasonable, despite any tax-avoidance motive, so long as the corporation engages in bona fide economically-based business transactions."
  - In reaching its conclusion that the transaction at issue had economic substance, the District Court relied upon the following undisputed facts:
    - BDHMI assumed the responsibility for the management, servicing, and administration of plaintiff's employee and retiree health plans;
    - BDHMI considered and proposed numerous healthcare cost containment strategies since its inception, many of which have been implemented by Black & Decker;
    - BDHMI has always maintained salaried employees; and
    - BDHMI became responsible for paying the healthcare claims of Black & Decker's employees and such claims are paid with the corporation's assets.

# The Most Recent Case Law: Coltec Industries, Inc.

- *Coltec Industries, Inc.*, Case No. 01-072T (Fed. Cl. Oct. 29, 2004)
  - In a lengthy opinion released on November 2, 2004, the United States Court of Federal Claims entered judgment in favor of Coltec Industries, Inc. (“Coltec"), upholding the $370 million capital loss claimed by Coltec from the contingent liability transaction at issue in this tax refund litigation.
  - The transaction was structured in similar fashion to the transaction at issue in *Black & Decker* and the “listed” transaction described by the IRS in Notice 2001-17.
  - In the transaction at issue, Coltec transferred contingent asbestos litigation liabilities and an intercompany note to a newly-created subsidiary, formed for the purpose of managing the liabilities, in exchange for stock in the subsidiary.
  - Coltec then sold the stock received in the exchange to Nationsbank and First Union to establish the market price of the stock for subsequent sales to service providers. Coltec claimed $370 million in capital losses from the stock sales.
  - Two years later, Coltec sold additional stock in the subsidiary to a select group of lawyers involved in defending its asbestos claims to provide these lawyers an additional performance incentive.

# The Most Recent Case Law: Coltec Industries, Inc.

- *Coltec Industries, Inc.*, Case No. 01-072T (Fed. Cl. Oct. 29, 2004)
  - The court held that the operation of the applicable code sections justified a capital loss and rejected the government's argument that the capital loss should nonetheless be disallowed under the economic substance doctrine.
  - The court refused to apply the economic substance doctrine to the transaction because the transaction satisfied the statutory requirements of the Code. The court stated, "it is Congress, not the court, that should determine how the federal tax laws should be used to promote economic welfare…where the taxpayer has satisfied all statutory requirements established by Congress, as Coltec did in this case, the use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers."
  - In determining that the transaction satisfied the statutory requirements for a capital loss, the court determined that Coltec's basis in the stock of its subsidiary that was subsequently sold to Nationsbank and First Union should not be reduced by the amount of the contingent asbestos liabilities transferred to the subsidiary.
    - The court held that contingent liabilities are not "liabilities" for purposes of reducing basis under section 358(d).
    - The court stated that even if section 358(d) applied to the liabilities, section 357(c)(3) would preclude the liabilities from reducing basis because they "would give rise to a deduction." The court relied upon the analysis of section 357(c)(3) in *Black & Decker,* which concluded that there was no authority to limit the application of section 357(c)(3) only to situations where the liabilities would give rise to a deduction to the transferee (as opposed to the transferor).
    - The court also held that section 357(b) did not apply to reduce Coltec's basis in the subsidiary stock because there was a valid business purpose for the assumption of the liabilities. In determining that there was a valid business purpose, the court relied upon the testimony of Coltec employees as to the non-tax purposes of the transaction.

# The Most Recent Case Law: TIFD III-E, Inc.

- *TIFD-III-E, Inc. v. United States*, Case No. 3:01-1839 (D. Conn. Nov. 1, 2004)
  - In an opinion dated November 1, 2004, the District Court for the District of Connecticut granted judgment in favor of the taxpayer in the amount of $62.2 million in this tax refund action.
  - The defendant had challenged the restructuring of General Electric Capital Corporation's ("GECC") aircraft leasing business in a newly-formed partnership with two foreign banks as partners.
  - In exchange for their cash investments, the foreign banks were provided a return on their capital investments and shared in the economic outcome of GECC's leasing business.
  - Under the terms of the partnership agreement, 98 percent of the operating income of the partnership was assigned to the foreign banks, thereby reducing GECC's tax liability with respect to operating income by $62.2 million over the life of the partnership.
  - The Internal Revenue Service challenged the allocation of income to foreign banks on three grounds:
    - The overall transaction lacked "economic substance."
    - The foreign banks should be treated as lenders, not partners, for tax purposes, and therefore could not be allocated partnership income.
    - The manner in which the partnership income was allocated violated the "overall tax effect" rule of section 704(b) of the Code.

# The Most Recent Case Law: TIFD III-E, Inc.

- *TIFD-III-E, Inc. v. United States*, Case No. 3:01-1839 (D. Conn. Nov. 1, 2004)
  - The court held in favor of the taxpayer on each of the arguments raised by the government.
  - First, the court found that the formation of the partnership had "economic substance" under the Second Circuit Court of Appeals' sham transaction standard because it had real non-tax economic effects and a non-tax business purpose.
    - The foreign banks contributed more than $117 million to the partnership, which was used to purchase aircraft and retire debt, this establishing a real economic effect to the transaction.
    - GECC had a legitimate business purpose for the transaction to raise additional capital and to demonstrate to investors, rating agencies, and GECC senior management that it could raise capital on its aging aircraft.
  - Second, the court determined that the foreign banks were real partners in the partnership, not merely lenders for tax purposes, because the formation of the partnership had economic substance and the Code provides no basis to disregard economically substantial partnerships.
  - Third, the court found that the allocation of the partnership's operating income primarily to the foreign banks did not violate the "overall tax effect" rule of section 704 because the allocation had a "substantial" economic effect because the foreign banks agreed to receive and actually did receive the economic benefit of 98% of the operating income of the partnership.

# Developments to Watch

# Developments to Watch

- New markers on the tax shelter map. Compare:
  - A structure that brings tax efficiencies to a transaction integral to your business:
    - *Frank Lyon*
    - *UPS*
    - *Black & Decker*, *Coltec*, *TIFD III-E*
  - A financial transaction that is complex and not in furtherance of the core mission of your business
    - *Gregory*
    - *ACM*
    - *LTCH*

# Developments to Watch

- Reliance on Opinion Letters to Avoid Penalties:
  - Under *Long Term Capital Holdings*, opinion letters may no longer provide penalty protection in tax-advantaged transactions that are determined to lack economic substance in litigation.
  - *Long Term Capital Holdings* places an increased burden upon taxpayers to "look behind" the opinions rendered by outside tax counsel.
  - Opinion letters of "disqualifed tax advisors" may not be relied upon for penalty protection for listed transactions and reportable transactions with a "significant purpose" of tax avoidance or evasion.
    - Material advisor includes those who provide aid "organizing" or "implementing" a reportable transaction

# Developments to Watch

- The Dollar Impact:
  - Once the court determines the transaction doesn't work, then what?
    - Deny tax effect to the entire transaction
    - Give tax effect to certain elements of the deal
    - Similar to issue for individuals in 1980s shelter cases:
      - The note that was never to be paid proved the shelter was a sham
      - Did cancellation of the note give rise to COD income?
  - What about out of pocket expenses?
  - Developments relating to interest

# Developments to Watch

- Top Ten Developments in the Current Enforcement Environment
  - Will recent cases revive efforts to codify the economic substance doctrine?
  - The message from the top:  the Commissioner's priorities
  - Criminal prosecutions
  - Settlement offers pulled in the wake of *LTCH*, but government reaction yet to *Black & Decker*, *Coltec*, or *TIFD III-E*
  - Enforcement consequences of Congressional action on IRS budget request
  - Pre-filing audits
    - Syracuse report on impact of audit currency initiatives
  - SEC as a model, and a source of information?
  - Getting deals on the angel lists
  - No-fault penalties for failure to disclose
  - Sabanes Oxley sections 303 and 802

# Evaluating Your Transactions:

# Practical Tips From the Trenches

# Economic Substance
# Factors From Case Law

- Favorable Factors
  - Transaction had genuine economic consequences to taxpayer and other parties involved in transaction—*UPS*, *Sacks*
  - Transaction undertaken by existing business entities and did not involve the creation of new entities solely for the purpose of transaction—*IES*, *Compaq*
  - Results of transaction are not fixed--taxpayer has potential for gain/risk of loss from transaction—*CM Holdings*
  - Transaction involved real economic outlay by taxpayer—*ACM*, *CM Holdings*
  - Transaction generated an actual economic loss equivalent to capital loss—*ACM*
  - Potential for economic profit from transaction is not de minimis when compared with tax benefit—*Salina Partnership*, *Saba Partnership* (District Court—dicta)
  - Key aspects of transaction (interest rates, purchase price of property) are not inflated to create greater tax benefit—*Dow*

# Economic Substance
# Factors From Case Law

- Negative Factors
  - Transaction involves circular cash flows and offsetting transactions to reduce economic outlay by taxpayer—*ACM*, *CM Holdings*, *Nicole Rose*
  - Results of transaction are locked in and guaranteed with virtually no risk of loss, potential for gain--*ACM*, *CM Holdings*
  - Transaction takes place over a very short period of time—*ACM*, *Saba Partnership* (District Court—dicta)
  - Use of foreign entity not subject to U.S. taxation is essential aspect of transaction—*ACM*, *Saba Partnership* (Dist. Ct.—dicta)
  - Economic loss from deal not equivalent to capital loss—*ACM*
  - Potential for economic profit from transaction is de minimis when compared with tax benefit—*Saba Partnership* ($10.8 million in potential profits compared with $170 million capital loss) (District Court—dicta)
  - Aspects of transaction (interest rates, price of property) are inflated to create greater tax benefit—*CM Holdings*, *Winn-Dixie*

# Business Purpose
# Factors From Case Law

- Favorable Factors
  - Transaction originates in non-tax function of taxpayer—*ASA Investerings*, *Boca Investerings*, *Saba Partnership*
  - Even though transaction originates in tax function, structure is adopted and supported by non-tax function and management—*Boca Investerings* (District Court—dicta)
  - Transaction addresses business concerns/profit seeking efforts raised by non-tax function —*Boca Investerings* (District Court—dicta), *Salina Partnership*
  - Ultimate decision whether to undertake transaction is based primarily on non-tax factors —*Boca Investerings* (District Court—dicta), *Salina Partnership*
  - Transaction involves restructuring of an existing business activity—*UPS*
  - Transaction involves formation of a genuine business--*Sacks*
  - Taxpayer undertakes efforts to structure transaction to maximize profit and reduce risk of loss—*IES*, *Compaq*

# Business Purpose
# Factors From Case Law

- Negative Factors
  - No independent, non-tax business purpose for the transaction—*ASA Investerings*, *Boca Investerings*, *Saba Partnership*
  - Transaction planned and executed without regard to pre-tax economic consequences—*ACM*, *Saba Partnership* (Tax Court—now dicta)
  - Internal memoranda prepared by taxpayer prior to transaction focus exclusively on tax benefits of transaction—*ASA Investerings*, *Boca Investerings*, *Saba Partnership*, *Long Term Capital Holdings* ("*LTCH*")
  - Transaction structured in a manner where it can not generate a pre-tax profit—*Winn-Dixie*, *CM Holdings*
  - Plan is marketed to taxpayer by a promoter as a tax-driven investment—*CM Holdings*, *Saba Partnership*, *LTCH*

# Business Purpose
# Factors From Case Law

- Negative Factors, cont.
  - Asserted business purpose relates to use of tax-generated savings from transaction, not pre-tax profit potential—*Winn-Dixie*
  - Transaction considered by Tax Director only—*LTCH*
  - When purported business purpose is to further taxpayer's core business, transaction furthers taxpayer's core business only at the cost of complex machinations and large transaction costs, which had not otherwise been required to further taxpayer's core business in past—*LTCH*
  - Transaction requires taxpayer to waive investment requirements that had applied to all prior investment transactions—*LTCH*
  - Testimony of taxpayer's owners indicates that they viewed the transaction as a tax transaction—*LTCH*

# Practical Tips from the Trenches

- What are other companies doing, and what should you do?
  - Have business purpose for every transaction
  - Make sure there is an economic benefit without tax benefits
  - Exception to above if there is clear congressional intent through a provision of the Code specifically allowing the tax benefit (e.g., low income housing)
  - Make sure you get an appropriate opinion from a competent, trustworthy and independent advisor
  - Talk to your auditors about appropriate financial reserves
  - Make sure everyone knows in advance that you will disclose the matter on the tax return if there is any doubt about it, and
  - Always keep senior management informed

# Practical Tips from the Trenches

- Identifying potentially troublesome transactions
  - Do what you can to make sure lines of communication are good between the tax department and the business units
    - "Embedding" a tax person may or may not be practical
    - Try to make it known that you should be consulted
  - Set up a process to identify potentially troubling transactions
    - Either educate the business units, or make sure they alert the tax department to deals
      - If the deals are too numerous, have the business units identify classes of deals

# Practical Tips from the Trenches

- Once transactions are identified
  - Elevate issues within the organization when appropriate
  - Obtain second opinions on non-routine tax matters
  - Place little weight on promoter opinions in assessing planning ideas

# Practical Tips from the Trenches

- Using the factors from the cases:
  - Prefer deals that contain favorable factors above
  - Scrutinize deals that contain negative factors above

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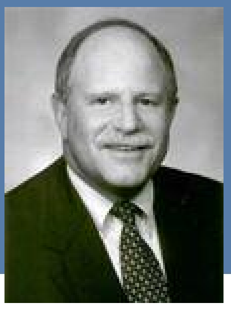

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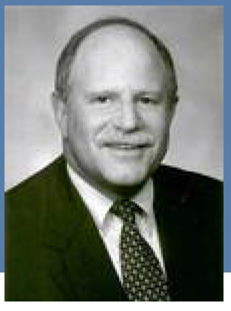
Mark J. Silverman heads Steptoe & Johnson's tax practice. He is a member of The American Law Institute, Tax Advisory Group for the Study of Subchapter C of the Internal Revenue Code. He was formerly an advisor to the Committee on Ways and Means during their consideration of revisions to the corporate tax provisions of the Internal Revenue Code. He is a Fellow of the American College of Tax Counsel. Mr. Silverman was formerly a Council member of the American Bar Association, Section of Taxation and was formerly Chair of the Corporate Tax Committee. He chaired the Tax Section Task Force on Leveraged Buyouts. Mr. Silverman co-authored the Tax Advisors Planning Series on Financially Troubled Businesses, he was formerly Corporate Tax Editor of The Journal of Taxation, and is a member of the advisory boards of NYU Institute on Federal Taxation, BNA Tax Management, Consolidated Returns Tax Report, M&A Tax Report and Corporate Taxation magazines. Mr. Silverman is on the Editorial Board of The American Journal of Tax Policy, and is on the Board of Trustees of the Southern Federal Tax Institute. Mr. Silverman chairs the ALI-ABA annual consolidated returns program. Mr. Silverman was formerly a member of the Executive Committee of the New York State Bar Association. In addition, he is an Adjunct Professor of Law at Georgetown University Law Center and was formerly attorney- advisor to Judge Samuel B. Sterrett of the United States Tax Court. Mr. Silverman is a frequent speaker on tax matters and has published numerous articles on the subject.



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**Planning and Transactional Practice**

Mr. Silverman focuses on planning and transactional matters. He has extensive experience in structuring acquisitions, mergers, and spin-off transactions for large public corporations, as well as closely held businesses. He has authored a book on the tax consequences of financially troubled businesses and advises corporations on consolidated return issues. Mr. Silverman advises leverage buyout groups, venture capitalists and privately held commercial real estate developers with respect to various transactional matters. He is often called upon to advise the Internal Revenue Service, Treasury Department and the staffs of the Congressional tax writing committees with respect to corporate tax issues.

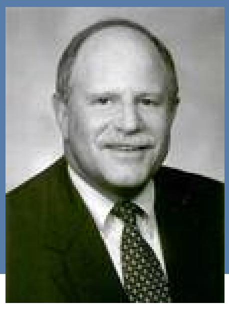
**Tax Policy Practice**

A significant part of Mr. Silverman's practice involves the resolution of tax policy issues before Congress and the Treasury Department. These issues arise in the context of pending or proposed legislation and proposed Treasury Department regulations. Mr. Silverman is currently meeting with members of Congress and their staffs on many of the corporate tax provisions proposed by the Administration and by members of Congress (including corporate spin-offs, financial product provisions, and corporate capital gains).

**Audit and Controversy**

Mr. Silverman also handles audit and controversy matters. He has extensive experience negotiating with field agents, appeals officers and district counsel in settling significant audit issues. Mr. Silverman frequently prepares technical advice requests and often meets with National Office officials with respect to audit and tax litigation matters.

Recently, Mr. Silverman was successful in convincing the National Office to reverse its position with respect to a technical advice memorandum involving the deduction of environmental clean-up costs.



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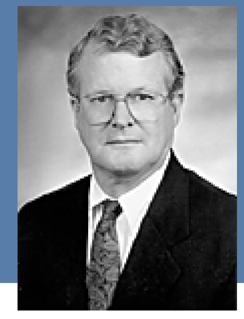

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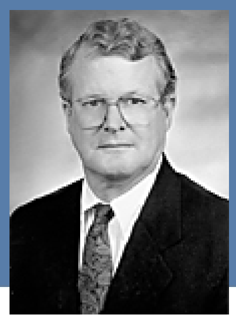
Arthur L. Bailey is a partner with the Washington, DC-based law firm of Steptoe & Johnson LLP. Prior to joining the firm in 1983, Mr. Bailey was Vice President and General Counsel at Phoenix Mutual Life Insurance Company in Hartford, Connecticut. He also held various tax positions at both the Internal Revenue Service and the Tax Division at the Department of Justice.

Mr. Bailey's practice is focused on tax controversy matters including practice before the Internal Revenue Service and in the federal courts. He routinely represents corporate taxpayers before IRS Appeals and the National Office in traditional tax controversies involving the application of complex statutes to corporate taxpayers.

Mr. Bailey also has experience in resolving disputes (without resort to litigation) involving tax advantaged transactions such as COLI, contingent liability transactions, and other transactions---working with IRS officials within the Office of Tax Shelter Analysis as well as high level executives within LMSB and Appeals that have responsibility for developing the Service's position with respect to these and other issues.

Mr. Bailey has been lead trial counsel in cases tried in the Tax Court, the Court of Federal Claims, as well as in several United States District Courts ( Ohio, Connecticut, and the District of Columbia). In addition, he has briefed and argued important tax cases in the federal appellate courts including the United States Courts of Appeals for the First, Second, Third, Fourth, Fifth, Sixth, Eighth, Ninth, and Tenth Circuits, as well as in the Federal Circuit and in the United States Court of Appeals for the District of Columbia Circuit. Having recently completed a six week bench trial in an "electronic" courtroom, Mr. Bailey is experienced in working with advanced technology in a trial setting.

Mr. Bailey has been active in the Tax Section of the ABA . He is currently an advisor to a seminar jointly sponsored by the Federal Bar Association together with the Internal Revenue Service. Mr. Bailey regularly speaks or moderates panels addressing current issues in tax controversy matters.



# Arthur L. Bailey (cont'd)

PROFESSIONAL AFFILIATIONS
American Bar Association, Section of Taxation, Committee on Insurance Companies Advisory Council, Hartford Institute on Insurance Taxation Northeast Tax Study (NETS) Group

Federal Bar Association, Section of Taxation, Advisory Committee

MEMBERSHIP IN STATE BARS
District of Columbia

# Matthew D. Lerner

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Washington, DC 20036

AREAS OF PRACTICE
Tax

EDUCATION
Harvard University
J.D., magna cum laude, 1985
Editor, Harvard Law Review

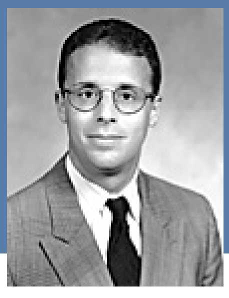
Amherst College
A.B., Economics, 1982
Phi Beta Kappa
Nelson Prize in Economics

Matthew D. Lerner is a partner with the Washington, DC-based law firm of Steptoe & Johnson LLP. He practices primarily in the area of federal taxation, with substantial experience in tax litigation, as well as business planning and advice. Prior to joining the firm, he was a partner in a small tax firm.

**Federal Civil Tax Litigation**
Mr. Lerner's experience in federal civil tax litigation covers a broad spectrum of representation at all stages of the Internal Revenue Service's (IRS) administrative audit process and litigation in Tax Court, the Court of Federal Claims and the Federal district courts. He handles tax controversies for corporations, partnerships and individuals.

Mr. Lerner's experience extends both to the process of managing tax controversies at the various administrative and judicial levels, and to numerous substantive areas of federal tax law. Among the matters he has recently handled for clients are cases involving the appropriate tax treatment of: losses from trading in securities and commodities; corporate spin-offs and liquidations; corporate takeovers; miscellaneous corporate fees and expenses, international intercorporate transactions (sections 482 and 936); and mining transactions. He has also handled cases involving the accumulated earnings tax.

**Federal Criminal Tax Litigation**
Mr. Lerner has represented numerous individuals in the course of federal criminal tax investigations. He has managed all aspects of grand jury investigations, including large-scale document production and witness preparation, and has made successful pre-indictment presentations to the Department of Justice on behalf of clients accused of tax crimes. Mr. Lerner also has experience in post-indictment motions practice, including the preparation of motions to dismiss indictments on substantive grounds and bail and discovery motions.



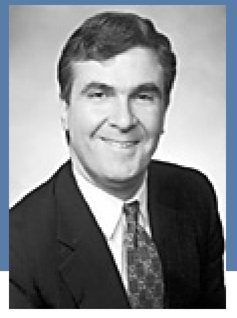
# Matthew D. Lerner (cont'd)

PROFESSIONAL AFFILIATIONS
Member, DC Bar Taxation Section

MEMBERSHIP IN
STATE BARS
District of Columbia

**Business Advice**
Mr. Lerner assists small businesses with all aspects of their development. He provides both tax and planning advice to assist start-up companies to take advantage of their new business opportunities, while complying with state and federal regulatory and tax requirements. He negotiates and drafts contracts for corporations and individuals, including asset purchase, licensing, employment and business separation contracts. Mr. Lerner also assists large corporations by providing tax advice with respect to issues arising out of their business transactions, including incorporation, mergers and acquisitions, divestitures and liquidation.

# Philip R. West



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AREAS OF PRACTICE
Tax

EDUCATION
Georgetown University Law Center
LL.M. in Taxation, 1987

New York Law School
J.D., cum laude, 1984

Baruch Graduate School of Business
M.B.A. coursework, 1983-84

State University of New York, Brockport
B.S., 1981

Center for Economic and Political
Studies London Semester, 1980

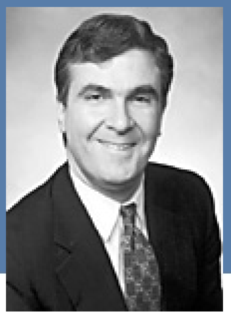
MEMBERSHIP IN
STATE BARS
New York
District of Columbia

Philip R. West is a tax partner in the business solutions group of Steptoe & Johnson LLP. Mr. West assists both domestic and foreign clients, focusing mainly on international tax issues.

Mr. West has extensive experience dealing with the IRS and the courts on audits, controversies, and rulings. For nearly 20 years, he has worked on all sides of the tax shelter issue, representing tax shelter investors in private practice and suing tax shelter promoters as a Justice Department litigator, evaluating tax shelters as a member of an international accounting firm and advising investment banks on tax advantaged financial products while at a Wall Street law firm, helping to decide tax shelter cases as a Tax Court clerk, and setting policy on tax shelter issues as a Treasury Department official.

Over the years, Mr. West has developed extensive practical experience minimizing the tax cost of international business operations and transactions, including mergers, acquisitions, dispositions, joint ventures and financings; forming investment funds on a tax-neutral basis; assisting clients with the adoption and documentation of transfer pricing strategies; counseling clients on tax minimization structures and transactions; and advising clients on discrete technical matters. He also has extensive practical experience dealing with the Treasury Department and Congress on technical matters as well as issues of broad policy significance.

Mr. West served for nearly four years as the Treasury Department's International Tax Counsel, the senior international tax lawyer in the US government. In that position he played a central role in virtually every policy, legislative, and regulatory development in the international tax area and led tax treaty negotiations, discussions, and ratification efforts involving countries throughout the world. Mr. West also led numerous official delegations to the Organization for Economic Cooperation and Development (OECD) and on other missions. He has practical experience with many foreign tax systems and good relationships with foreign tax officials and private practitioners around the world.



# Philip R. West (cont'd)

HONORS & DISTINCTIONS
ABA Tax Section Foreign Lawyers Forum, Vice-Chair, 2002-present

ABA Task Force on Int'l Tax Reform, 2002-present

Congressional Working Group on Int'l Tax Reform, Advisor, 2002

NYU Law School/IRS Professional Education Program, Board Member, 2001-present

Harvard Law School, Guest Lecturer, 1993-96, 2003

Georgetown University Law Center, Adjunct Professor, 1997-1999

US Treasury Dept., Exceptional Service Award, 2000

NYSBA Tax Section, Executive Committee and Co-Chair, International Tax Committees, 1991-96

Journal of Taxation of Global Transactions, Advisory Board, 2001-present

The Tax Lawyer, Editorial Board, 1995-present

Council of the Americas, Advisory Board, 1995-96

**Selected Publications**
Mr. West speaks frequently to professional audiences and has written numerous articles and other publications on international tax topics. Selected works include:

"International Joint Ventures: Selected Practical Considerations," 55 *International Bureau for Fiscal Documentation Bulletin* 484, September/October 2001 (reprinted in *Practicing Law Institute, Tax Planning for Domestic and Foreign Partnerships, LLCs, Joint Ventures and Other Strategic Alliances*, June 2002).

"Attribution of Profits to a Permanent Establishment - A US Perspective," *International Tax Review*, July 2001.

"Highlights of The New US-UK Treaty," 92 *Tax Notes* 663, July 30, 2001.

"The Use of Foreign Law in US International Taxation: The Search for Standards," 3 *Florida Tax Review* 147, 1996.

Co-Author, "Inversions and the Continuing Saga of General Utilities Repeal," Vol. 3, No. 7 *The M&A Tax Report 1*, February 1995.

Co-Author, "The Reach of General Utilities Repeal," Vol. 3, No. 5 *The M&A Tax Report 1*, December 1994.

"The Seventh Circuit Rules on Certain Controversial Foreign Tax Credit Issues: Continental Illinois v. Commissioner," 22 *Tax Management International Journal* 539, October 8, 1993.

"Cost Sharing," *Transfer Pricing Handbook* (John Wiley & Sons, Inc., 1993).