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What To Do When Your Tax Shelter Blows Up

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EDUCATION
Harvard University
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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 controversy and 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 Controversies and Litigation

Mr. Lerner's experience in federal civil tax controversies 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 has substantial experience with various IRS dispute resolution processes, including Pre-Filing Agreements, Industry Issue Resolution, Fast Track Settlement, Early Referral to IRS Appeals, and submission of Requests for Technical Advice. Mr. Lerner also counsels clients on pre-audit issues including document retention, audit file preparation, and disclosure obligations.

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, accounting method issues, a broad range of so-called "tax shelters," and promoter registration and penalty issues.



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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.

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, and 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.

What To Do When Your Tax Shelter Blows Up

Overview

- What is a tax shelter?
 - Tips to Avoid Tax Shelter Blow Ups
- The Audit Process
 - Anticipating the Audit
 - Conducting the Audit
 - Post-Audit Process
- Establishing and Preserving Privileges
 - Attorney-Client Privilege
 - Work Product Doctrine
- Tax Shelter Reporting and Penalty Rules

What To Do When Your Tax Shelter Blows Up

Introduction

- Recent Growth of Tax Shelters:
 - “Considering a Tax Shelter? Think. Then Think Again,” N.Y. Times, Feb. 17, 2005
 - “Report Gives New Details on KPMG Shelters,” N.Y. Times, Feb. 11, 2005
- The I.R.S. Attacks With New Penalty Provisions and Internal Coordination
 - “I.R.S. Offers Lower Penalty if Shelter Abusers Confess,” N.Y. Times, Feb. 23, 2005
- The world is far different now than it was 5 years ago.

What Is A Tax Shelter?

- The term “tax shelter” is thrown around loosely and inaccurately
- There are statutory and regulatory definitions of “tax shelters” for different purposes:
 - “a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.” Sec. 6662(d)(2)(C)(ii).
 - “A partnership or other entity (such as a corporation or trust), [a]n investment plan or arrangement, or [a]ny other plan or arrangement, if the principal purpose of the entity, plan or arrangement, based on objective evidence, is to avoid or evade Federal income tax.” Treas. Reg. § 1.6662-4(g)(2).

What Is A Tax Shelter?

More colloquially, a “tax shelter” is a transaction that may have one or more of the following characteristics:

- ♦ Lack of meaningful economic risk of loss or potential for gain
- ♦ Inconsistent financial and accounting treatment of an item
- ♦ Presence of tax indifferent parties
- ♦ Unnecessary steps or novel investments
- ♦ Promotion or marketing tax benefits
- ♦ Risk reduction arrangements

Being a “tax shelter” does not mean that the transaction fails

Tips To Avoid Tax Shelters

Principles to Follow

- Research economics of the transaction -- Is there a reasonable profit possibility? What has to happen to earn profits?
- Document the non-tax reasons for the transaction -- your expectations, projections, etc.
- Are you involved in the investment decisions?
- Investigate the people involved in the transaction -- How are they compensated? Percentage of the tax savings? Investigate their backgrounds/track records
- If you are not comfortable with the people involved, consider consulting with your independent (not connected with the transaction) attorney and/or financial advisor
- If it seems too good to be true, IT IS!
- Save transaction documentation – economic projections, studies of market, etc.

So You Invested In A Tax Shelter, What Now?

■ Considerations:

- The Audit Process - how to prepare and successfully navigate in choppy waters
 - ◆ Privileges (Attorney and Accountant) – What's confidential and how to keep it that way?
- Settlement vs. Litigation
- Tax Shelter Penalties

The Audit Process

- **Anticipating the Audit – Don't Wait Until It's Too Late**
 - Principles to Live By
 - Considerations for all transactions
 - Considerations for tax shelters
 - IRS programs to facilitate pre-audit issue resolution
 - Practical tips from the trenches
- **Conducting the Audit**
 - Setting parameters
 - Responding to IDRs
- **Post-Audit Process**
 - Examinations to Appeals
 - Examinations – practical tips
 - Administrative settlement and mediation
 - IRS actions
 - Taxpayer responses
 - Litigation

Anticipating the Audit

Principles to Live By

What is an audit? Generally, an audit is an IRS examination of the documents supporting an item (typically a deduction or loss) claimed on a tax return

- The audit can either be internal (within the IRS' offices) or external (in your home or office)
- IRS has broad authority to examine returns, books and records, etc.
- IRS is successfully employing a “carrot and stick” approach to learn about tax advantaged transactions
- Hire competent counsel experienced in dealing with the IRS and audits; always anticipate litigation

Anticipating the Audit Considerations For All Transactions

1. Transaction participants should create a written record
2. Most documents will not be privileged and must be produced
3. Contemporaneous communications will be persuasive evidence of business purpose
4. Communications should avoid jumping to conclusions or speculating
5. Communications include email and “soft” and “hard” copies of documents

Anticipating the Audit Considerations For All Transactions “Maintain and Retain”

1. Maintain and retain all documents, especially those that relate to structure and conduct of transaction
 - Create a file for each transaction
 - Maintain a log of each person with whom you spoke, the subject matter, and date
2. Document identities of participants in the transaction
3. Memorialize critical facts and analyses

Anticipating the Audit Considerations For Tax Shelters

1. IRS lawyers are involved earlier; IRS is making tax shelters a priority
2. More coordination within branches of IRS
3. Disclose, disclose, disclose! IRS is requiring greater disclosure to “smoke out” transactions

Anticipating the Audit Consideration for Tax Shelters

Coordination of IRS Divisions

- Examination Guide for abusive tax shelters and transactions
- Use of pattern IDRs
- Requests for waiver of attorney-client privilege
- Issuance of administrative summonses to obtain documents, including tax opinions
- Assignment of specific coordinators for particular shelter issues
- Creation of the Office of Tax Shelter Analysis – info gathering and analysis
- Settlement initiatives

Anticipating the Audit Consideration for Tax Shelters Disclosure

Disclose, Disclose, Disclose!

■ **Required Disclosure**

- Must disclose “reportable transactions” – file Form 8886
 - ◆ Non-disclosure penalties: \$10,000 for individuals/\$50,000 for all others
- Must disclose “listed transactions”
 - ◆ Non-disclosure penalties: \$100,000 for individuals/\$200,000 for all others
- No disclosure, no “reasonable cause” exception available

Anticipating the Audit Consideration for Tax Shelters Disclosure

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

- What are “listed” transactions?
 - The IRS has identified numerous transactions which it has “listed” or determined to be “tax avoidance transactions,” that is abusive, lacking substance, and entered into predominantly for the tax benefits achieved. Definition includes reportable transactions which are “substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction.” (Sec. 6707A(d)).
 - ♦ Examples of listed transactions include, BOSS transactions (Notice 99-59), LILO transactions (Rev. Rul. 2002-69), and abusive Roth IRA transactions (Notice 2004-8), and SILO transactions (Notice 2005-13)

 - A transaction’s being listed does not mean you will lose if you contest the issue.

Anticipating the Audit

IRS Programs to Facilitate Pre-Audit Issue Resolution

- **IRS Initiatives to Resolve and Identify “Abusive Tax Shelters” and Transactions**
 - IRS has conducted several settlement initiatives to resolve tax shelter cases before examination. In return for such resolution, the IRS has adopted a policy of waiving or reducing penalties that would otherwise be levied. Examples of such initiatives are:
 - ◆ COLI and §351 contingent liabilities transactions
 - ◆ The “Son of BOSS” initiative announced in May 2004

Anticipating the Audit

Practical Tips from the Trenches

- Selecting an audit advisor:
 - ◆ Experienced in the audit process?
 - ◆ Known and trusted?
 - ◆ Able to deal respectfully and forcefully?
 - ◆ Willing to settle?
- Who will be the decision-maker? Does your audit advisor have settlement authority?
- When to make settlement offer? Get in early? Or wait-and-see?

Anticipating the Audit

Practical Tips from the Trenches

- How to handle an interview
 - Practice
 - ◆ Role-play with your audit advisor
 - Privilege (see discussion which follows)
 - Tips for testifying
 - ◆ Always pause and think before you answer, give advisor chance to object
 - ◆ Speak slowly
 - ◆ Look the agent in the eye
 - ◆ Try not to be defensive
 - ◆ Avoid unequivocal answers

Anticipating the Audit

Practical Tips from the Trenches

- Centrally Controlled Issue? Is transaction being widely attacked?
 - An Appeals Coordinated Issue (ACI) is an issue or category of case of Service-wide impact or importance that requires Appeals' coordination to ensure uniformity and consistency nationwide. This is achieved through the coordination of efforts between appeals officers and designated ACI coordinators

- If tax shelter issue is “coordinated,” form a group of similarly situated transaction participants. Share costs and strengthen bargaining position.

Conducting the Audit Setting Parameters

■ Audit Management Plan

- Development of audit plan and timetable
- Seek to control IRS access to documents and information
- Designate competent counsel with whom IRS will interact during the examination

Conducting the Audit

Responding to IDRs

■ Responding to IDRs

- IRS obtains information and documents via an Information Document Request or “IDR”
- Taxpayers often attempt to narrow scope of IDRs with examination team prior to responding
- IDRs or other requests for information can be issued to third parties, but IRS must provide taxpayer with notice upon request

Post-Audit Process Examination to Appeals

- No Change Cases - examiner proposes no change in the taxpayer's liability; the tax liability shown on the return is accepted by the IRS as filed
- Examiner Proposes Adjustments
 - Agreed Cases - the taxpayer does not wish to contest the adjustments, he should sign the standard Form 870 (Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment) and pay the deficiency
 - Unagreed Cases - taxpayer does not agree with proposed changes
 - ◆ Manager's Conference
 - No agreement with agent's manager, taxpayer can utilize Fast Track Process (see discussion below)
 - No agreement with agent's manager and no Fast Track, "30-day letter" issued (see discussion below)

Post-Audit Process Examinations – Practical Tips

- Unlike Appeals, Examination Division cannot do “hazards of litigation” analysis. Examination Division either determines that the treatment of an item is correct or incorrect.
 - Creative method to resolve case at the Examination Division – “split the baby”. For example, 2 issues under examination, one issue determined in favor of the IRS and one issue determined in favor of the taxpayer – approximates a “hazards of litigation” analysis.

Post-Audit Process

Administrative Settlement and Mediation

- Fast Track Program - IRS has optional programs to resolve cases before going to Appeals and court. Fast Track started as a pilot program in November 2001 (Public Notice 2001-76). Became permanent in 2003 (Rev. Procs. 2003-40 and 2003-41).
 - Appeals Officer trained in mediation seeks to facilitate communication and resolve factual issues. Mediator does not exercise settlement authority and does not render a decision. Officer may recommend a settlement based upon his analysis of issues and facts.
- If no settlement is reached, taxpayer maintains appeals rights and whenever possible case will be assigned to an Appeals Officer not involved in the Fast Track process.

Post-Audit Process

IRS Actions

- **IRS Action – Issuance of the “30-day letter” and Revenue Agent’s Report (“RAR”)**
 - RAR contains Notice of Proposed Adjustments and a recomputation (as adjusted) of the tax
 - Taxpayer has 30 days in which to protest and seek administrative review by IRS’ Appeals Division
 - Taxpayer has no “right” to 30-day letter; not issued when statute of limitations period is getting short

Post-Audit Process

Taxpayer Responses

■ Taxpayer Response to 30-Day Letter

1. Tentatively agree to proposed deficiency
 - Sign Form 870, waiving restriction on assessment
 - Waives right to file suit in Tax Court
 - Taxpayer can pursue refund suit in District Court or Court of Federal Claims
2. Fail to respond to 30-day letter
 - IRS will issue 90-day letter (statutory notice of deficiency)
 - Taxpayer has 90 days to file suit in Tax Court, if petition not filed, IRS will assess deficiency after the 90-day period has expired, then start the collection process
3. File protest
 - Taxpayer ostensibly has 30 days to file a protest
 - Can request extension of time

Post-Audit Process

Appeals Division

- What is the Appeals Division?
 - The Appeals Division serves as the administrative forum for any taxpayer contesting an IRS compliance action. The department has offices nationwide which are separate from and independent of the IRS office that proposed the adjustment to your tax return or issued the notices about collecting taxes due.
 - An Appeals or Settlement Officer will review the strengths and weaknesses of the issues in your case and give them a *fresh look*. Such reviews are conducted in an informal manner, by correspondence, telephone or at a personal conference. Most differences are settled in these appeals without expensive and time-consuming court trials. For tax shelters, the settlement rate is less impressive.
 - Appeals Division can do “hazards of litigation” analysis.

Post-Audit Process Litigation

■ Choice of Forum

- Tax Court
- U.S. District Court
- Court of Federal Claims

■ Preparation for Litigation

- Tax Court Litigation
- Refund Litigation

Post-Audit Process Litigation

■ Choice of Forum

- Has the Tax Court, U.S. District Court, or Court of Federal Claims decided the issue before?
- Is there precedent in the Court of Appeals where the taxpayer resides or in the Federal Circuit Court of Appeals?
- Is the desired outcome more likely to come from a judge experienced in handling tax matters or from a judge without specialized tax knowledge?
- Do you want a jury?

Post-Audit Process Litigation Tax Court

■ Advantages

- Cost effective – no pay to play, limitations on discovery = lower litigation costs
- Streamlined discovery and pre-trial process
- Well-defined body of tax law and judges have expertise in tax

■ Disadvantages

- Recent precedent unfavorable for tax advantaged transactions
- IRS can raise “new issues” at time of trial
- Case opens entire taxable year not just single issue

Post-Audit Process Litigation U.S. District Court

■ Advantages

- Recent precedent somewhat more favorable for tax advantaged transactions
- DOJ handles cases with settlement authority somewhat independently of IRS
- Court not bound by Tax Court precedent
- Evidence and procedure rules more closely followed
- Right to demand trial by jury

■ Disadvantages

- Refund suit - must pay to play; litigation costs higher
- Possibility of extensive discovery delaying resolution
- Judges are generalists not typically experienced in tax matters

Post-Audit Process Litigation Court of Federal Claims

■ Advantages

- DOJ handles cases; settlement authority independent of IRS
- Federal Circuit precedent more favorable toward taxpayers
- Court not bound by Tax Court precedent
- Judges are more experienced than District Court Judges with tax matters

■ Disadvantages

- Refund suit - must pay to play; litigation costs higher than Tax Court
- Possibility of extensive discovery delaying resolution

Establishing and Preserving Privileges

Attorney-Client Privilege – General Rule

What is the attorney-client privilege?

- Bars the forced disclosure of communications made between an attorney and his client or a person seeking to be a client with an expectation of confidentiality, made outside the presence of third parties, for the purpose of securing legal services.
- Exists to encourage “full and frank communications between attorneys and their clients and thereby promote broader public interests in the observance of the law and the administration of justice.”
- Privilege is waived if the communication is later disclosed to a third party and adequate steps to prevent disclosure were not taken.

Establishing and Preserving Privileges

Attorney-Client Privilege – Other Issues

- Communications with External Legal Advisors
 - Attorney-client privilege generally attaches to communications with outside counsel
 - Privilege extends to law firm employees who assist attorneys in providing legal advice
 - Attorneys employed by accounting firms are generally not considered to be functioning for the purpose of the attorney-client privilege
 - Communications among attorneys for similarly situated clients may be privileged under the “common interest” doctrine

Establishing and Preserving Privileges

Attorney-Client Privilege – Other Issues

- Extension of Privilege to Non-Attorneys
 - Kovel Agreement – Privilege extended to accountants and other experts hired to assist attorney in understanding complex issues in the provision of legal advice
 - Tax advice provided to in-house counsel by accounting firm is generally not protected by attorney-client privilege (but may be protected by accountant-client privilege or work-product doctrine)
 - Investment advice provided to in-house counsel by an investment firm regarding a transaction is not privileged
- Preparation of Tax Return Information
 - Preparation of tax return information is generally not privileged

Establishing and Preserving Privileges

Attorney-Client Privilege – Waiver

- Actual Waiver
 - Actual waiver occurs if there is a voluntary disclosure of a privileged document to a third party, the waiver is with respect to all parties, and the waiver is with respect to all communications of the same “subject matter”
 - Courts differ in defining scope of “subject matter” waiver
 - Courts split as to whether an inadvertent disclosure represents an actual waiver or is not a waiver
- Implied Waiver
 - Applies when privilege holder asserts a claim that in fairness requires examination of protected communications
 - Tax Court – Three part balancing test to determine implied waiver

Establishing and Preserving Privileges

Work Product Doctrine

What is the work product doctrine?

- A rule governing disclosure of certain materials -- Rule 26(b)(3) of the Federal Rules of Civil Procedure
 - General Rule – Documents prepared “in anticipation of litigation” or for trial by and for another party, or by or for that other party’s representatives, are protected from disclosure
 - Mental impressions of attorneys/other representatives are protected
 - Substantial Need Exception
- “In Anticipation of Litigation” Standard
 - “Primarily to Assist in Litigation” Test
 - “Because of Litigation” Test
 - Level of anticipation
- Waiver of protection

Establishing and Preserving Privileges

Accountant-Client Privilege

What is the accountant-client privilege?

- Section 7525 of the Internal Revenue Code
 - Applies to communications made after July 22, 1998, between “federally authorized tax practitioners” and clients
 - Intended to apply similarly to attorney-client privilege
 - Does not apply to certain “tax shelter” transactions (i.e., transaction with a “significant” purpose of tax avoidance or evasion)
 - The privilege may only be asserted by taxpayer or one acting on his behalf in any noncriminal proceeding before IRS or any noncriminal tax proceeding brought in Federal court.
- Limitation for Accountant Opinion Letters
 - *KPMG Case* – Tax opinion prepared by accountants is not protected by privilege because it was “prepared in connection with preparation of a tax return”
 - *Adlman Case* – Tax opinion prepared by accountants may be protected by work product doctrine if prepared in anticipation of litigation

Establishing and Preserving Privileges

Handling Documents If Litigation Is Expected

- Maintain Limited Access to Legal Documents
 - Do not disclose privileged documents to others
- Separate and clearly mark privileged communications to avoid inadvertent waiver of privileged/work product protection
- No privilege will attach to business/financial documents, so store them in a separate location from legal documents

Establishing and Preserving Privileges

Practical Considerations for Maintaining Privileges

- Involve your attorney in communications and document preparation to the greatest extent possible
- Enter into written agreement through counsel with third-party consultants to whom you wish to disclose privileged information
- Be very cautious in disclosing sensitive materials to accounting firm, even if it is for the purpose of providing tax advice
- Avoid inappropriate claims of privilege on documents
- Be aware of the disclosures of information/documents to the IRS pursuant to the new taxpayer disclosure regulations (Treas. Reg. § 1.6011-4) which may waive any privilege claims with respect to the documents

Tax Shelter Provisions

Reporting and Penalty Rules

- Supercharged Tax Shelter Penalties:
 - Failing to Disclose Penalties (new section 6707A)
 - Accuracy-related penalties (new section 6662A)

Tax Shelter Provisions

Reporting and Penalty Rules

Disclosure Penalties

- **Penalty for failing to disclose tax shelter transaction (new section 6707A)**
 - Amount of Penalty:
 - ♦ \$10,000 individuals/\$50,000 all others for “reportable” transactions
 - ♦ \$100,000 individuals/\$200,000 all others for “listed” transaction
 - Treasury given authority to define what constitutes a “reportable” transaction and a “listed” transaction in regulations under section 6011
 - Penalty cannot be waived for failing to report a “listed” transaction
 - ♦ Can argue transaction was not otherwise a “substantially similar” transaction

Tax Shelter Provisions

Reporting and Penalty Rules

Disclosure Penalties

- **Penalty for failing to disclose a tax shelter transaction (new section 6707A), continued**
 - Notice 2005-11 grants the IRS authority to rescind the penalty for failing to disclose a “reportable” transaction (not for a listed transaction) based upon:
 - Whether the taxpayer has a history of complying with the tax laws;
 - Whether the violation is due to an unintentional mistake of fact; and
 - Whether 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

Tax Shelter Provisions

Reporting and Penalty Rules

Accuracy-Related Penalties

- **Two-tier accuracy related penalty for “reportable” transactions (new section 6662A)**
 - **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 not 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
 - 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

Reporting and Penalty Rules

Accuracy-Related Penalties

- **Two-tier accuracy related penalty for “reportable” transactions (new section 6662A), continued**
 - IRS can waive the 20% penalty 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; and
 - ♦ 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 upon the facts and law existing at the time of the tax return, and
 - ♦ Relates solely to the taxpayer’s chances of success on the merits and does not take in to consideration 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

Reporting and Penalty Rules

Accuracy-Related Penalties

■ Two-tier accuracy related penalty for “reportable” transactions (new section 6662A), continued

- Section 6664(d) -- A taxpayer may rely on a tax advisor’s opinion in establishing his belief, as long as:
 - ♦ the advisor is not considered a “disqualified tax advisor” or
 - ♦ the opinion is not a “disqualified opinion”
- A “disqualified tax advisor” is any advisor who:
 - ♦ Is a material advisor (as defined in section 6111);
 - ♦ Is compensated directly or indirectly by a material advisor to the transaction;
 - ♦ Has a fee arrangement contingent upon the success of the transaction; or
 - ♦ Has a “disqualifying financial interest” in the transaction
- A “disqualified opinion” is an opinion that:
 - ♦ Is based upon “unreasonable factual or legal assumptions;”
 - ♦ “Unreasonably relies” upon representations, statements, findings, or arrangements of any person, including the taxpayer; or
 - ♦ Does not identify or consider all relevant facts

Tax Shelter Provisions

Reporting and Penalty Rules

Accuracy-Related Penalties

- **Two-tier accuracy related penalty for “reportable” transactions (new section 6662A), continued**
 - Coordination with other penalties
 - ♦ Any understatement upon which this penalty is imposed is not subject to section 6662’s accuracy related penalty
 - ♦ 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 does not apply to any portion of an understatement to which a fraud penalty under section 6663 applies

Tax Shelter Provisions

Accuracy-Related Penalties

Practical Tips – Tax Opinions

- Events and changes in the law since 2000 have taught us:
 - Get a written opinion
 - Not from a “material adviser”
 - Make sure the opinion does not assume away the economic substance and business purpose for the transaction
 - Opinion should support the economics of the transaction
 - The opinion should be from *your* advisor – an advisor independent from the transaction