

cause the nature of these transactions may make it difficult or impossible to compare them with third-party transactions.

In addition to the statutory rules governing the taxation of foreign income of U.S. persons and U.S. income of foreign persons, bilateral income tax treaties limit the amount of income tax that may be imposed by one treaty partner on residents of the other treaty partner. For example, treaties often reduce or eliminate withholding taxes imposed by a treaty country on certain types of income (e.g., dividends, interest and royalties) paid to residents of the other treaty country. Treaties also contain provisions governing the creditability of taxes imposed by the treaty country in which income was earned in computing the amount of tax owed to the other country by its residents with respect to such income. Treaties further provide procedures under which inconsistent positions taken by the treaty countries with respect to a single item of income or deduction may be mutually resolved by the two countries.

#### HOUSE BILL

The bill requires the Treasury Secretary to conduct and submit to the Congress three studies. The first study will examine the effectiveness of the transfer pricing rules of section 482, with an emphasis on transactions involving intangible property. The second study will examine income tax treaties to which the United States is a party, with a view toward identifying any inappropriate reductions in withholding tax or opportunities for abuse that may exist. The third study will examine the impact of the provisions of this bill on inversion transactions.

*Effective date.*—The tax treaty study required under the provision is due no later than June 30, 2005. The transfer pricing study required under the provision is due no later than June 30, 2005. The inversions study required under the provision is due no later than December 31, 2005.

#### SENATE AMENDMENT

No provision.

#### CONFERENCE AGREEMENT

The conference agreement follows the House bill, except the inversions study required under the provision is due no later than December 31, 2006.

#### B. PROVISIONS RELATING TO TAX SHELTERS

1. Penalty for failure to disclose reportable transactions (sec. 611 of the House bill, sec. 402 of the Senate amendment, and new sec. 6707A of the Code)

#### PRESENT LAW

Regulations under section 6011 require a taxpayer to disclose with its tax return certain information with respect to each “reportable transaction” in which the taxpayer participates.<sup>452</sup>

<sup>452</sup>On February 27, 2003, the Treasury Department and the IRS released final regulations regarding the disclosure of reportable transactions. In general, the regulations are effective for transactions entered into on or after February 28, 2003.

There are six categories of reportable transactions. The first category is any transaction that is the same as (or substantially similar to)<sup>453</sup> a transaction that is specified by the Treasury Department as a tax avoidance transaction whose tax benefits are subject to disallowance under present law (referred to as a “listed transaction”).<sup>454</sup>

The second category is any transaction that is offered under conditions of confidentiality. In general, a transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid a minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor’s tax strategies (irrespective if such terms are legally binding).<sup>455</sup>

The third category of reportable transactions is any transaction for which (1) the taxpayer has the right to a full or partial refund of fees if the intended tax consequences from the transaction are not sustained or, (2) the fees are contingent on the intended tax consequences from the transaction being sustained.<sup>456</sup>

The fourth category of reportable transactions relates to any transaction resulting in a taxpayer claiming a loss (under section 165) of at least (1) \$10 million in any single year or \$20 million in any combination of years by a corporate taxpayer or a partnership with only corporate partners; (2) \$2 million in any single year or \$4 million in any combination of years by all other partnerships, S corporations, trusts, and individuals; or (3) \$50,000 in any single year for individuals or trusts if the loss arises with respect to foreign currency translation losses.<sup>457</sup>

The fifth category of reportable transactions refers to any transaction done by certain taxpayers<sup>458</sup> in which the tax treatment of the transaction differs (or is expected to differ) by more than \$10 million from its treatment for book purposes (using generally accepted accounting principles) in any year.<sup>459</sup>

The final category of reportable transactions is any transaction that results in a tax credit exceeding \$250,000 (including a foreign tax credit) if the taxpayer holds the underlying asset for less than 45 days.<sup>460</sup>

Under present law, there is no specific penalty for failing to disclose a reportable transaction; however, such a failure can jeopardize a taxpayer’s ability to claim that any income tax understatement

The discussion of present law refers to the new regulations. The rules that apply with respect to transactions entered into on or before February 28, 2003, are contained in Treas. Reg. sec. 1.6011-4T in effect on the date the transaction was entered into.

<sup>453</sup>The regulations clarify that the term “substantially similar” includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Further, the term must be broadly construed in favor of disclosure. Treas. Reg. sec. 1.6011-4(c)(4).

<sup>454</sup>Treas. Reg. sec. 1.6011-4(b)(2).

<sup>455</sup>Treas. Reg. sec. 1.6011-4(b)(3).

<sup>456</sup>Treas. Reg. sec. 1.6011-4(b)(4).

<sup>457</sup>Treas. Reg. sec. 1.6011-4(b)(5). Rev. Proc. 2003-24, 2003-11 I.R.B. 599, exempts certain types of losses from this reportable transaction category.

<sup>458</sup>The significant book-tax category applies only to taxpayers that are reporting companies under the Securities Exchange Act of 1934 or business entities that have \$250 million or more in gross assets.

<sup>459</sup>Treas. Reg. sec. 1.6011-4(b)(6). Rev. Proc. 2003-25, 2003-11 I.R.B. 601, exempts certain types of transactions from this reportable transaction category.

<sup>460</sup>Treas. Reg. sec. 1.6011-4(b)(7).

ment attributable to such undisclosed transaction is due to reasonable cause, and that the taxpayer acted in good faith.<sup>461</sup>

#### HOUSE BILL

##### *In general*

The House bill creates a new penalty for any person who fails to include with any return or statement any required information with respect to a reportable transaction. The new penalty applies without regard to whether the transaction ultimately results in an understatement of tax, and applies in addition to any accuracy-related penalty that may be imposed.

##### *Transactions to be disclosed*

The House bill does not define the terms “listed transaction”<sup>462</sup> or “reportable transaction,” nor does it explain the type of information that must be disclosed in order to avoid the imposition of a penalty. Rather, the House bill authorizes the Treasury Department to define a “listed transaction” and a “reportable transaction” under section 6011.

##### *Penalty rate*

The penalty for failing to disclose a reportable transaction is \$10,000 in the case of a natural person and \$50,000 in any other case. The amount is increased to \$100,000 and \$200,000, respectively, if the failure is with respect to a listed transaction. The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the IRS Commissioner or his delegate can rescind (or abate) the penalty only if rescinding the penalty would promote compliance with the tax laws and effective tax administration. The decision to rescind a penalty must be accompanied by a record describing the facts and reasons for the action and the amount rescinded. There will be no taxpayer right to judicially appeal a refusal to rescind a penalty.<sup>463</sup> The IRS also is required to submit an annual report to Congress summarizing the application of the disclosure penalties and providing a description of each penalty rescinded under this provision and the reasons for the rescission.

##### *Effective date*

The House bill provision is effective for returns and statements the due date for which is after the date of enactment.

<sup>461</sup>Section 6664(c) provides that a taxpayer can avoid the imposition of a section 6662 accuracy-related penalty in cases where the taxpayer can demonstrate that there was reasonable cause for the underpayment and that the taxpayer acted in good faith. Regulations under sections 6662 and 6664 provide that a taxpayer’s failure to disclose a reportable transaction is a strong indication that the taxpayer failed to act in good faith, which would bar relief under section 6664(c).

<sup>462</sup>The House bill provides that, except as provided in regulations, a listed transaction means a reportable transaction, which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011. For this purpose, it is expected that the definition of “substantially similar” will be the definition used in Treas. Reg. sec. 1.6011-4(c)(4). However, the Secretary may modify this definition (as well as the definitions of “listed transaction” and “reportable transactions”) as appropriate.

<sup>463</sup>This does not limit the ability of a taxpayer to challenge whether a penalty is appropriate (e.g., a taxpayer may litigate the issue of whether a transaction is a reportable transaction (and thus subject to the penalty if not disclosed) or not a reportable transaction (and thus not subject to the penalty)).

## SENATE AMENDMENT

*In general*

The Senate amendment is the same as the House bill, with certain modifications.

*Transactions to be disclosed*

Like the House bill, the Senate amendment does not define the terms “listed transaction” or “reportable transaction” but, rather, authorizes the Treasury Department to define a “listed transaction” and a “reportable transaction” under section 6011.

*Penalty rate*

Under the Senate amendment, the penalty for failing to disclose a reportable transaction generally is \$50,000. The amount is increased to \$100,000 if the failure is with respect to a listed transaction. For large entities and high net worth individuals, the penalty amount is doubled (i.e., \$100,000 for a reportable transaction and \$200,000 for a listed transaction).

The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the penalty can be rescinded (or abated) only if: (1) the taxpayer on whom the penalty is imposed has a history of complying with the Federal tax laws, (2) it is shown that the violation is due to an unintentional mistake of fact, (3) imposing the penalty would be against equity and good conscience, and (4) rescinding the penalty would promote compliance with the tax laws and effective tax administration. The authority to rescind the penalty can only be exercised by the IRS Commissioner personally or the head of the Office of Tax Shelter Analysis. Thus, the penalty cannot be rescinded by a revenue agent, an Appeals officer, or any other IRS personnel. The decision to rescind a penalty must be accompanied by a record describing the facts and reasons for the action and the amount rescinded. There will be no taxpayer right to appeal a refusal to rescind a penalty. The IRS also is required to submit an annual report to Congress summarizing the application of the disclosure penalties and providing a description of each penalty rescinded under this provision and the reasons for the rescission.

A “large entity” is defined as any entity with gross receipts in excess of \$10 million in the year of the transaction or in the preceding year. A “high net worth individual” is defined as any individual whose net worth exceeds \$2 million, based on the fair market value of the individual’s assets and liabilities immediately before entering into the transaction.

A public entity that is required to pay a penalty for failing to disclose a listed transaction (or is subject to an understatement penalty attributable to a non-disclosed listed transaction, a non-disclosed reportable avoidance transaction,<sup>464</sup> or a transaction that lacks economic substance) must disclose the imposition of the penalty in reports to the Securities and Exchange Commission for such period as the Secretary shall specify. The provision applies without

<sup>464</sup> A reportable avoidance transaction is a reportable transaction with a significant tax avoidance purpose.

regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and treats any failure to disclose a transaction in such reports as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the Securities and Exchange Commission once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid). In addition, the Secretary is required to make public the name of any person that is required to pay a penalty for failing to disclose a listed transaction (or is subject to an understatement penalty attributable to a non-disclosed listed transaction, a non-disclosed reportable avoidance transaction, or a transaction that lacks economic substance), as well as the amount of such penalty.

*Effective date*

The Senate amendment provision is effective for returns and statements the due date for which is after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modifications.

In determining whether to rescind (or abate) the penalty for failing to disclose a reportable transaction on the grounds that doing so would promote compliance with the tax laws and effective tax administration, the conferees intend that the IRS Commissioner take into account whether: (1) the person on whom the penalty is imposed has a history of complying with the tax laws; (2) the violation is due to an unintentional mistake of fact; and (3) imposing the penalty would be against equity and good conscience.

In addition, the conference agreement provides that a public entity that is required to pay a penalty for failing to disclose a listed transaction (or is subject to an understatement penalty attributable to a non-disclosed listed transaction or a non-disclosed reportable avoidance transaction) must disclose the imposition of the penalty in reports to the Securities and Exchange Commission for such period as the Secretary shall specify. This requirement applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and treats any failure to disclose a transaction in such reports as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the Securities and Exchange Commission once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid). However, the taxpayer is only required to report the penalty one time. The conference agreement further provides that this requirement also applies to a public entity that is subject to a gross valuation misstatement penalty under section 6662(h) attributable to a non-disclosed listed transaction or non-disclosed reportable avoidance transaction.

2. Modifications to the accuracy-related penalties for listed transactions and reportable transactions having a significant tax avoidance purpose (sec. 612 of the House bill, sec. 403 of the Senate amendment, and new sec. 6662A of the Code)

PRESENT LAW

The accuracy-related penalty applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or \$5,000 (\$10,000 in the case of corporations), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.<sup>465</sup> The amount of any understatement generally is reduced by any portion attributable to an item if (1) the treatment of the item is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.<sup>466</sup>

Special rules apply with respect to tax shelters.<sup>467</sup> For understatements by non-corporate taxpayers attributable to tax shelters, the penalty may be avoided only if the taxpayer establishes that, in addition to having substantial authority for the position, the taxpayer reasonably believed that the treatment claimed was more likely than not the proper treatment of the item. This reduction in the penalty is unavailable to corporate tax shelters.

The understatement penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was “reasonable cause” for the underpayment and that the taxpayer acted in good faith.<sup>468</sup> The relevant regulations provide that reasonable cause exists where the taxpayer “reasonably relies in good faith on an opinion based on a professional tax advisor’s analysis of the pertinent facts and authorities [that] . . . unambiguously concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged” by the IRS.<sup>469</sup>

HOUSE BILL

*In general*

The House bill modifies the present-law accuracy related penalty by replacing the rules applicable to tax shelters with a new accuracy-related penalty that applies to listed transactions and reportable transactions with a significant tax avoidance purpose (hereinafter referred to as a “reportable avoidance transaction”).<sup>470</sup>

<sup>465</sup> Sec. 6662.

<sup>466</sup> Sec. 6662(d)(2)(B).

<sup>467</sup> Sec. 6662(d)(2)(C).

<sup>468</sup> Sec. 6664(c).

<sup>469</sup> Treas. Reg. sec. 1.6662-4(g)(4)(i)(B); Treas. Reg. sec. 1.6664-4(c).

<sup>470</sup> The terms “reportable transaction” and “listed transaction” have the same meanings as used for purposes of the penalty for failing to disclose reportable transactions.

The penalty rate and defenses available to avoid the penalty vary depending on whether the transaction was adequately disclosed.

*Disclosed transactions*

In general, a 20-percent accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed transaction or reportable avoidance transaction. The only exception to the penalty is if the taxpayer satisfies a more stringent reasonable cause and good faith exception (hereinafter referred to as the “strengthened reasonable cause exception”), which is described below. The strengthened reasonable cause exception is available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment.

*Undisclosed transactions*

If the taxpayer does not adequately disclose the transaction, the strengthened reasonable cause exception is not available (i.e., a strict-liability penalty applies), and the taxpayer is subject to an increased penalty equal to 30 percent of the understatement.

*Determination of the understatement amount*

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this provision, the amount of the understatement is determined as the sum of (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer’s treatment of the item and the proper treatment of the item (without regard to other items on the tax return),<sup>471</sup> and (2) 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.

Except as provided in regulations, a taxpayer’s treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.

*Strengthened reasonable cause exception*

A penalty is not imposed under the provision with respect to any portion of an understatement if it shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011,<sup>472</sup> (2) that there is or was substantial authority for such treatment, and (3) that the taxpayer reasonably believed that such

<sup>471</sup> For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income.

<sup>472</sup> See the previous discussion regarding the penalty for failing to disclose a reportable transaction.

treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief (1) is based on the facts and law that exist at the time the tax return (that includes the item) is filed, and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised.

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor," or (2) is a "disqualified opinion."

#### *Disqualified tax advisor*

A disqualified tax advisor is any advisor who (1) is a material advisor<sup>473</sup> and who participates in the organization, management, promotion or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates, (2) is compensated directly or indirectly<sup>474</sup> by a material advisor with respect to the transaction, (3) 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 (4) as determined under regulations prescribed by the Secretary, has a disqualifying financial interest with respect to the transaction.

*Organization, management, promotion or sale of a transaction.*—A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents (1) establishing a structure used in connection with the transaction (such as a partnership agreement), (2) describing the transaction (such as an offering memorandum or other statement describing the transaction), or (3) relating to the registration of the transaction with any federal, state or local government body.<sup>475</sup> Participation in the "management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in

<sup>473</sup> Under the House bill, the term "material advisor" (defined below in connection with the new information filing requirements for material advisors) means any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction, and who derives gross income in excess of \$50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons (\$250,000 in any other case).

<sup>474</sup> This situation could arise, for example, when an advisor has an arrangement or understanding (oral or written) with an organizer, manager, or promoter of a reportable transaction that such party will recommend or refer potential participants to the advisor for an opinion regarding the tax treatment of the transaction.

<sup>475</sup> An advisor should not be treated as participating in the organization of a transaction if the advisor's only involvement with respect to the organization of the transaction is the rendering of an opinion regarding the tax consequences of such transaction. However, such an advisor may be a "disqualified tax advisor" with respect to the transaction if the advisor participates in the management, promotion or sale of the transaction (or if the advisor is compensated by a material advisor, has a fee arrangement that is contingent on the tax benefits of the transaction, or as determined by the Secretary, has a continuing financial interest with respect to the transaction).

the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

*Disqualified opinion*

An opinion may not be relied upon if the opinion (1) is based on unreasonable factual or legal assumptions (including assumptions as to future events), (2) unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person, (3) does not identify and consider all relevant facts, or (4) fails to meet any other requirement prescribed by the Secretary.

*Coordination with other penalties*

Any understatement upon which a penalty is imposed under the House bill is not subject to the accuracy-related penalty under section 6662. However, such understatement is included for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1).

The penalty imposed under the House bill shall not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

*Effective date*

The House bill provision is effective for taxable years ending after the date of enactment.

SENATE AMENDMENT

*In general*

The Senate amendment is the same as the House bill, with certain modifications.

*Disclosed transactions*

The Senate amendment is the same as the House bill with regard to accuracy-related penalties for understatements attributable to an adequately disclosed listed transaction or reportable avoidance transaction.

*Undisclosed transactions*

Like the House bill, the Senate amendment provides that a taxpayer is subject to an increased accuracy-related penalty equal to 30 percent of the understatement, and the strengthened reasonable cause exception is not available (i.e., a strict-liability penalty applies), if the taxpayer does not adequately disclose the transaction.

Under the Senate amendment, a public entity that is required to pay the 30-percent penalty also must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be

material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

The Senate amendment also provides that, once the 30-percent penalty has been included in the Revenue Agent Report, the penalty cannot be compromised for purposes of a settlement without approval of the Commissioner personally or the head of the Office of Tax Shelter Analysis. Furthermore, the IRS is required to submit an annual report to Congress summarizing the application of this penalty and providing a description of each penalty compromised under this provision and the reasons for the compromise.

*Disqualified tax advisor*

The Senate amendment provides that a disqualified tax advisor also includes an advisor who has an arrangement with respect to the transaction which provides that contractual disputes between the taxpayer and the advisor are to be settled by arbitration or which limits damages by reference to fees paid to the advisor for such transaction.

*Determination of the understatement amount*

The Senate amendment is the same as the House bill with regard to determining the amount of an understatement that is subject to this provision.

*Strengthened reasonable cause exception*

The Senate amendment is the same as the House bill with regard to the reasonable cause exception to accuracy-related penalties under this provision.<sup>476</sup>

*Coordination with other penalties*

The Senate amendment is the same as the House bill with regard to coordination between the penalty imposed under this provision and other penalties.

*Effective date*

The Senate amendment provision is effective for taxable years ending after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, except the conference agreement also provides that any understatement upon which a penalty is imposed under the conference agreement is not subject to the valuation misstatement penalties under sections 6662(e) or 6662(h).

<sup>476</sup>Under the Senate amendment, the term "material advisor" (defined below in connection with the new information filing requirements for material advisors) means any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring or carrying out any reportable transaction, and who derives gross income in excess of \$50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons (\$250,000 in any other case).

3. Tax shelter exception to confidentiality privileges relating to taxpayer communications (sec. 613 of the House bill, sec. 406 of the Senate amendment, and sec. 7525 of the Code)

## PRESENT LAW

In general, a common law privilege of confidentiality exists for communications between an attorney and client with respect to the legal advice the attorney gives the client. The Code provides that, with respect to tax advice, the same common law protections of confidentiality that apply to a communication between a taxpayer and an attorney also apply to a communication between a taxpayer and a federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney. This rule is inapplicable to communications regarding corporate tax shelters.

## HOUSE BILL

The House bill modifies the rule relating to corporate tax shelters by making it applicable to all tax shelters, whether entered into by corporations, individuals, partnerships, tax-exempt entities, or any other entity. Accordingly, communications with respect to tax shelters are not subject to the confidentiality provision of the Code that otherwise applies to a communication between a taxpayer and a federally authorized tax practitioner.

*Effective date.*—The House bill provision is effective with respect to communications made on or after the date of enactment.

## SENATE AMENDMENT

The Senate amendment is the same as the House bill.

## CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

4. Statute of limitations for unreported listed transactions (sec. 614 of the House bill, sec. 416 of the Senate amendment, and sec. 6501 of the Code)

## PRESENT LAW

In general, the Code requires that taxes be assessed within three years<sup>477</sup> after the date a return is filed.<sup>478</sup> If there has been a substantial omission of items of gross income that totals more than 25 percent of the amount of gross income shown on the return, the period during which an assessment must be made is extended to six years.<sup>479</sup> If an assessment is not made within the required time periods, the tax generally cannot be assessed or collected at any future time. Tax may be assessed at any time if the taxpayer files a false or fraudulent return with the intent to evade tax or if the taxpayer does not file a tax return at all.<sup>480</sup>

<sup>477</sup>Sec. 6501(a).

<sup>478</sup>For this purpose, a return that is filed before the date on which it is due is considered to be filed on the required due date (sec. 6501(b)(1)).

<sup>479</sup>Sec. 6501(e).

<sup>480</sup>Sec. 6501(c).

## HOUSE BILL

The House bill extends the statute of limitations with respect to a listed transaction if a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction<sup>481</sup> which is required to be included (under section 6011) with such return or statement. The statute of limitations with respect to such a transaction will not expire before the date which is one year after the earlier of (1) the date on which the Secretary is furnished the information so required, or (2) the date that a material advisor (as defined in 6111) satisfies the list maintenance requirements (as defined by section 6112) with respect to a request by the Secretary. For example, if a taxpayer engaged in a transaction in 2005 that becomes a listed transaction in 2007 and the taxpayer fails to disclose such transaction in the manner required by Treasury regulations, then the transaction is subject to the extended statute of limitations.<sup>482</sup>

*Effective date.*—The House bill provision is effective for taxable years with respect to which the period for assessing a deficiency did not expire before the date of enactment.

## SENATE AMENDMENT

The Senate amendment is the same as the House bill.

## CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

5. Disclosure of reportable transactions by material advisors (secs. 615 and 616 of the House bill, secs. 407 and 408 of the Senate amendment, and secs. 6111 and 6707 of the Code)

## PRESENT LAW

*Registration of tax shelter arrangements*

An organizer of a tax shelter is required to register the shelter with the Secretary not later than the day on which the shelter is first offered for sale.<sup>483</sup> A “tax shelter” means any investment with respect to which the tax shelter ratio<sup>484</sup> for any investor as of the close of any of the first five years ending after the investment is offered for sale may be greater than two to one and which is: (1) required to be registered under Federal or State securities laws, (2) sold pursuant to an exemption from registration requiring the fil-

<sup>481</sup>The term “listed transaction” has the same meaning as described in a previous provision regarding the penalty for failure to disclose reportable transactions.

<sup>482</sup>If the Treasury Department lists a transaction in a year subsequent to the year in which a taxpayer entered into such transaction and the taxpayer’s tax return for the year the transaction was entered into is closed by the statute of limitations prior to the date the transaction became a listed transaction, this provision does not re-open the statute of limitations with respect to such transaction for such year. However, if the purported tax benefits of the transaction are recognized over multiple tax years, the provision’s extension of the statute of limitations shall apply to such tax benefits in any subsequent tax year in which the statute of limitations had not closed prior to the date the transaction became a listed transaction.

<sup>483</sup>Sec. 6111(a).

<sup>484</sup>The tax shelter ratio is, with respect to any year, the ratio that the aggregate amount of the deductions and 350 percent of the credits, which are represented to be potentially allowable to any investor, bears to the investment base (money plus basis of assets contributed) as of the close of the tax year.

ing of a notice with a Federal or State securities agency, or (3) a substantial investment (greater than \$250,000 and involving at least five investors).<sup>485</sup>

Other promoted arrangements are treated as tax shelters for purposes of the registration requirement if: (1) a significant purpose of the arrangement is the avoidance or evasion of Federal income tax by a corporate participant; (2) the arrangement is offered under conditions of confidentiality; and (3) the promoter may receive fees in excess of \$100,000 in the aggregate.<sup>486</sup>

In general, a transaction has a “significant purpose of avoiding or evading Federal income tax” if the transaction: (1) is the same as or substantially similar to a “listed transaction,”<sup>487</sup> or (2) is structured to produce tax benefits that constitute an important part of the intended results of the arrangement and the promoter reasonably expects to present the arrangement to more than one taxpayer.<sup>488</sup> Certain exceptions are provided with respect to the second category of transactions.<sup>489</sup>

An arrangement is offered under conditions of confidentiality if: (1) an offeree has an understanding or agreement to limit the disclosure of the transaction or any significant tax features of the transaction; or (2) the promoter knows, or has reason to know, that the offeree’s use or disclosure of information relating to the transaction is limited in any other manner.<sup>490</sup>

#### *Failure to register tax shelter*

The penalty for failing to timely register a tax shelter (or for filing false or incomplete information with respect to the tax shelter registration) generally is the greater of one percent of the aggregate amount invested in the shelter or \$500.<sup>491</sup> However, if the tax shelter involves an arrangement offered to a corporation under conditions of confidentiality, the penalty is the greater of \$10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration. Intentional disregard of the requirement to register increases the penalty to 75 percent of the applicable fees.

Section 6707 also imposes (1) a \$100 penalty on the promoter for each failure to furnish the investor with the required tax shelter identification number, and (2) a \$250 penalty on the investor for each failure to include the tax shelter identification number on a return.

<sup>485</sup> Sec. 6111(c).

<sup>486</sup> Sec. 6111(d).

<sup>487</sup> Treas. Reg. sec. 301.6111-2(b)(2).

<sup>488</sup> Treas. Reg. sec. 301.6111-2(b)(3).

<sup>489</sup> Treas. Reg. sec. 301.6111-2(b)(4).

<sup>490</sup> The regulations provide that the determination of whether an arrangement is offered under conditions of confidentiality is based on all the facts and circumstances surrounding the offer. If an offeree’s disclosure of the structure or tax aspects of the transaction are limited in any way by an express or implied understanding or agreement with or for the benefit of a tax shelter promoter, an offer is considered made under conditions of confidentiality, whether or not such understanding or agreement is legally binding. Treas. Reg. sec. 301.6111-2(c)(1).

<sup>491</sup> Sec. 6707.

## HOUSE BILL

*Disclosure of reportable transactions by material advisors*

The House bill repeals the present law rules with respect to registration of tax shelters. Instead, the House bill requires each material advisor with respect to any reportable transaction (including any listed transaction)<sup>492</sup> to timely file an information return with the Secretary (in such form and manner as the Secretary may prescribe). The return must be filed on such date as specified by the Secretary.

The information return will include (1) information identifying and describing the transaction, (2) information describing any potential tax benefits expected to result from the transaction, and (3) such other information as the Secretary may prescribe. It is expected that the Secretary may seek from the material advisor the same type of information that the Secretary may request from a taxpayer in connection with a reportable transaction.<sup>493</sup>

A “material advisor” means any person (1) who provides material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction, and (2) who directly or indirectly derives gross income for such assistance or advice in excess of \$250,000 (\$50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons) or such other amount as may be prescribed by the Secretary.

The Secretary may prescribe regulations which provide (1) that only one material advisor has to file an information return in cases in which two or more material advisors would otherwise be required to file information returns with respect to a particular reportable transaction, (2) exemptions from the requirements of this section, and (3) other rules as may be necessary or appropriate to carry out the purposes of this section (including, for example, rules regarding the aggregation of fees in appropriate circumstances).

*Penalty for failing to furnish information regarding reportable transactions*

The House bill repeals the present-law penalty for failure to register tax shelters. Instead, the House bill imposes a penalty on any material advisor who fails to file an information return, or who files a false or incomplete information return, with respect to a reportable transaction (including a listed transaction).<sup>494</sup> The amount of the penalty is \$50,000. If the penalty is with respect to a listed transaction, the amount of the penalty is increased to the greater of (1) \$200,000, or (2) 50 percent of the gross income of such person with respect to aid, assistance, or advice which is provided with respect to the transaction before the date the information return that includes the transaction is filed. Intentional disregard by a mate-

<sup>492</sup> The terms “reportable transaction” and “listed transaction” have the same meaning as previously described in connection with the taxpayer-related provisions.

<sup>493</sup> See the previous discussion regarding the disclosure requirements under new section 6707A.

<sup>494</sup> The terms “reportable transaction” and “listed transaction” have the same meaning as previously described in connection with the taxpayer-related provisions.

rial advisor of the requirement to disclose a listed transaction increases the penalty to 75 percent of the gross income.

The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the penalty can be rescinded (or abated) only in exceptional circumstances.<sup>495</sup> All or part of the penalty may be rescinded only if rescinding the penalty would promote compliance with the tax laws and effective tax administration. The decision to rescind a penalty must be accompanied by a record describing the facts and reasons for the action and the amount rescinded. There will be no right to judicially appeal a refusal to rescind a penalty. The IRS also is required to submit an annual report to Congress summarizing the application of the disclosure penalties and providing a description of each penalty rescinded under this provision and the reasons for the rescission.

#### *Effective date*

The House bill provision requiring disclosure of reportable transactions by material advisors applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment.

The House bill provision imposing a penalty for failing to disclose reportable transactions applies to returns the due date for which is after the date of enactment.

#### SENATE AMENDMENT

The Senate amendment is the same as the House bill, except the Senate amendment also includes in the definition of a “material advisor” any person who provides material aid, assistance, or advice with respect to insuring any reportable transaction (and who derives gross income for such assistance or advice in excess of the amounts specified in the House bill).

#### CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

6. Investor lists and modification of penalty for failure to maintain investor lists (secs. 615 and 617 of the House bill, secs. 407 and 409 of the Senate amendment, and secs. 6112 and 6708 of the Code)

#### PRESENT LAW

#### *Investor lists*

Any organizer or seller of a potentially abusive tax shelter must maintain a list identifying each person who was sold an interest in any such tax shelter with respect to which registration was required under section 6111 (even though the particular party may not have been subject to confidentiality restrictions).<sup>496</sup> Recently issued regulations under section 6112 contain rules regarding the list maintenance requirements.<sup>497</sup> In general, the regulations apply

<sup>495</sup> The Secretary’s present-law authority to postpone certain tax-related deadlines because of Presidentially-declared disasters (sec. 7508A) will also encompass the authority to postpone the reporting deadlines established by the provision.

<sup>496</sup> Sec. 6112.

<sup>497</sup> Treas. Reg. sec. 301.6112-1.

to transactions that are potentially abusive tax shelters entered into, or acquired after, February 28, 2003.<sup>498</sup>

The regulations provide that a person is an organizer or seller of a potentially abusive tax shelter if the person is a material advisor with respect to that transaction.<sup>499</sup> A material advisor is defined as any person who is required to register the transaction under section 6111, or expects to receive a minimum fee of (1) \$250,000 for a transaction that is a potentially abusive tax shelter if all participants are corporations, or (2) \$50,000 for any other transaction that is a potentially abusive tax shelter.<sup>500</sup> For listed transactions (as defined in the regulations under section 6011), the minimum fees are reduced to \$25,000 and \$10,000, respectively.

A potentially abusive tax shelter is any transaction that (1) is required to be registered under section 6111, (2) is a listed transaction (as defined under the regulations under section 6011), or (3) any transaction that a potential material advisor, at the time the transaction is entered into, knows is or reasonably expects will become a reportable transaction (as defined under the new regulations under section 6011).<sup>501</sup>

The Secretary is required to prescribe regulations which provide that, in cases in which two or more persons are required to maintain the same list, only one person would be required to maintain the list.<sup>502</sup>

#### *Penalty for failing to maintain investor lists*

Under section 6708, the penalty for failing to maintain the list required under section 6112 is \$50 for each name omitted from the list (with a maximum penalty of \$100,000 per year).

#### HOUSE BILL

#### *Investor lists*

Each material advisor<sup>503</sup> with respect to a reportable transaction (including a listed transaction)<sup>504</sup> is required to maintain a list that (1) identifies each person with respect to whom the advisor acted as a material advisor with respect to the reportable transaction, and (2) contains other information as may be required by the Secretary. In addition, the provision authorizes (but does not require) the Secretary to prescribe regulations which provide that, in cases in which two or more persons are required to maintain the same list, only one person would be required to maintain the list.

#### *Penalty for failing to maintain investor lists*

The provision modifies the penalty for failing to maintain the required list by making it a time-sensitive penalty. Thus, a material advisor who is required to maintain an investor list and who

<sup>498</sup> A special rule applies the list maintenance requirements to transactions entered into after February 28, 2000 if the transaction becomes a listed transaction (as defined in Treas. Reg. 1.6011-4) after February 28, 2003.

<sup>499</sup> Treas. Reg. sec. 301.6112-1(c)(1).

<sup>500</sup> Treas. Reg. sec. 301.6112-1(c)(2) and (3).

<sup>501</sup> Treas. Reg. sec. 301.6112-1(b).

<sup>502</sup> Sec. 6112(c)(2).

<sup>503</sup> The term "material advisor" has the same meaning as when used in connection with the requirement to file an information return under section 6111.

<sup>504</sup> The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related provisions.

fails to make the list available upon written request by the Secretary within 20 business days after the request will be subject to a \$10,000 per day penalty. The penalty applies to a person who fails to maintain a list, maintains an incomplete list, or has in fact maintained a list but does not make the list available to the Secretary. The penalty can be waived if the failure to make the list available is due to reasonable cause.<sup>505</sup>

*Effective date*

The House bill provision requiring a material advisor to maintain an investor list applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment. The House bill provision imposing a penalty for failing to maintain investor lists applies to requests made after the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill. In addition, the Senate amendment clarifies that, for purposes of section 6112, the identity of any person is not privileged under the common law attorney-client privilege (or, consequently, the section 7525 federally authorized tax practitioner confidentiality provision).

*Effective date.*—The Senate amendment provision clarifying that the identity of any person is not privileged for purposes of section 6112 is effective as if included in the amendments made by section 142 of the Deficit Reduction Act of 1984.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

7. Penalty on promoters of tax shelters (sec. 618 of the House bill, sec. 415 of the Senate amendment, and sec. 6700 of the Code)

PRESENT LAW

A penalty is imposed on any person who organizes, assists in the organization of, or participates in the sale of any interest in, a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if in connection with such activity the person makes or furnishes a qualifying false or fraudulent statement or a gross valuation overstatement.<sup>506</sup> A qualified false or fraudulent statement is any statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter. A “gross valuation overstatement” means any statement as to the value of any property or services if the stated value exceeds 200 percent of the correct valuation, and the value is directly related to the amount of any allowable income tax deduction or credit.

<sup>505</sup>In no event will failure to maintain a list be considered reasonable cause for failing to make a list available to the Secretary.

<sup>506</sup>Sec. 6700.

The amount of the penalty is \$1,000 (or, if the person establishes that it is less, 100 percent of the gross income derived or to be derived by the person from such activity). A penalty attributable to a gross valuation misstatement can be waived on a showing that there was a reasonable basis for the valuation and it was made in good faith.

#### HOUSE BILL

The House bill modifies the penalty amount to equal 50 percent of the gross income derived by the person from the activity for which the penalty is imposed. The new penalty rate applies to any activity that involves a statement regarding the tax benefits of participating in a plan or arrangement if the person knows or has reason to know that such statement is false or fraudulent as to any material matter. The enhanced penalty does not apply to a gross valuation overstatement.

*Effective date.*—The House bill provision is effective for activities occurring after the date of enactment.

#### SENATE AMENDMENT

The Senate amendment modifies the penalty amount to equal 100 percent of the gross income derived by the person from the activity for which the penalty is imposed. The new penalty rate applies to (1) each instance of any activity that involves a statement (including a gross valuation overstatement) regarding the tax benefits of participating in a plan or arrangement if the person knows or has reason to know that such statement is false or fraudulent as to any material matter, (2) each instance in which income was derived from such activity, and (3) each person who participated in such activity. In addition, the Senate amendment imposes joint and several liability upon all persons who are subject to a penalty for such activity. The Senate amendment also provides that the payment of a penalty under this provision, or the payment of any amount to settle or avoid the imposition of such a penalty, is not deductible for tax purposes.

*Effective date.*—The Senate amendment provision is effective for activities occurring after the date of enactment.

#### CONFERENCE AGREEMENT

The conference agreement follows the House bill.

8. Penalty for aiding and abetting the understatement of tax liability (sec. 419 of the Senate amendment and sec. 6701 of the Code)

#### PRESENT LAW

A penalty is imposed on a person who: (1) aids or assists in or advises with respect to a tax return or other document; (2) knows (or has reason to believe) that such document will be used in connection with a material tax matter; and (3) knows that this would result in an understatement of tax of another person. In general, the amount of the penalty is \$1,000. If the document relates to the tax return of a corporation, the amount of the penalty is \$10,000.

## HOUSE BILL

No provision.

## SENATE AMENDMENT

The Senate amendment expands the scope of this penalty in several ways. First, it applies the penalty to aiding or assisting with respect to tax liability. Second, it applies the penalty to each instance of aiding or abetting. Third, it increases the amount of the penalty to a maximum of 100 percent of the gross income derived (or to be derived) from the aiding or abetting. Fourth, if more than one person is liable for the penalty, all such persons are jointly and severally liable for the penalty. Fifth, the penalty, as well as amounts paid to settle or avoid the imposition of the penalty, is not deductible for tax purposes.

*Effective date.*—The Senate amendment provision is effective for activities after the date of enactment.

## CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

9. Modifications of substantial understatement penalty for non-reportable transactions (sec. 619 of the House bill, sec. 405 of the Senate amendment, and sec. 6662 of the Code)

## PRESENT LAW

An accuracy-related penalty equal to 20 percent applies to any substantial understatement of tax. A “substantial understatement” exists if the correct income tax liability for a taxable year exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or \$5,000 (\$10,000 in the case of most corporations).<sup>507</sup>

## HOUSE BILL

The House bill modifies the definition of “substantial” for corporate taxpayers. Under the House bill, a corporate taxpayer has a substantial understatement if the amount of the understatement for the taxable year exceeds the lesser of (1) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, \$10,000), or (2) \$10 million.

*Effective date.*—The House bill provision is effective for taxable years beginning after date of enactment.

## SENATE AMENDMENT

The Senate amendment is the same as the House bill with regard to modifying the definition of “substantial” for corporate taxpayers.

In addition, the Senate amendment elevates the standard that a taxpayer must satisfy in order to reduce the amount of an understatement for undisclosed items. With respect to the treatment of an item whose facts are not adequately disclosed, a resulting understatement is reduced only if the taxpayer had a reasonable be-

<sup>507</sup>Sec. 6662(a) and (d)(1)(A).

lief that the tax treatment was more likely than not the proper treatment.

The Senate amendment also authorizes (but does not require) the Secretary to publish a list of positions for which it believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper treatment (without regard to whether such positions affect a significant number of taxpayers). The list shall be published in the Federal Register or the Internal Revenue Bulletin.

*Effective date.*—The Senate amendment provision is effective for taxable years beginning after the date of enactment.

#### CONFERENCE AGREEMENT

The conference agreement follows the House bill, except the conference agreement also modifies the requirement of the Secretary to prescribe a list of positions that do not have substantial authority, and authorizes (but does not require) the Secretary to publish such list.

10. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions (sec. 620 of the House bill, sec. 410 of the Senate amendment, and sec. 7408 of the Code)

#### PRESENT LAW

The Code authorizes civil actions to enjoin any person from promoting abusive tax shelters or aiding or abetting the understatement of tax liability.<sup>508</sup>

#### HOUSE BILL

The House bill expands this rule so that injunctions may also be sought with respect to the requirements relating to the reporting of reportable transactions<sup>509</sup> and the keeping of lists of investors by material advisors.<sup>510</sup> Thus, under the House bill, an injunction may be sought against a material advisor to enjoin the advisor from (1) failing to file an information return with respect to a reportable transaction, or (2) failing to maintain, or to timely furnish upon written request by the Secretary, a list of investors with respect to each reportable transaction.

*Effective date.*—The House bill provision is effective on the day after the date of enactment.

#### SENATE AMENDMENT

The Senate amendment is the same as the House bill, except the Senate amendment also permits injunctions to be sought with respect to violations of any of the rules under Circular 230, which regulates the practice of representatives of persons before the Department of the Treasury.

#### CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

<sup>508</sup> Sec. 7408.

<sup>509</sup> Sec. 6707, as amended by other provisions of this bill.

<sup>510</sup> Sec. 6708, as amended by other provisions of this bill.

11. Penalty on failure to report interests in foreign financial accounts (sec. 621 of the House bill, sec. 412 of the Senate amendment, and sec. 5321 of Title 31, United States Code)

## PRESENT LAW

The Secretary must require citizens, residents, or persons doing business in the United States to keep records and file reports when that person makes a transaction or maintains an account with a foreign financial entity.<sup>511</sup> In general, individuals must fulfill this requirement by answering questions regarding foreign accounts or foreign trusts that are contained in Part III of Schedule B of the IRS Form 1040. Taxpayers who answer “yes” in response to the question regarding foreign accounts must then file Treasury Department Form TD F 90–22.1. This form must be filed with the Department of the Treasury, and not as part of the tax return that is filed with the IRS.

The Secretary may impose a civil penalty on any person who willfully violates this reporting requirement. The civil penalty is the amount of the transaction or the value of the account, up to a maximum of \$100,000; the minimum amount of the penalty is \$25,000.<sup>512</sup> In addition, any person who willfully violates this reporting requirement is subject to a criminal penalty. The criminal penalty is a fine of not more than \$250,000 or imprisonment for not more than five years (or both); if the violation is part of a pattern of illegal activity, the maximum amount of the fine is increased to \$500,000 and the maximum length of imprisonment is increased to 10 years.<sup>513</sup>

On April 26, 2002, the Secretary submitted to the Congress a report on these reporting requirements.<sup>514</sup> This report, which was statutorily required,<sup>515</sup> studies methods for improving compliance with these reporting requirements. It makes several administrative recommendations, but no legislative recommendations. A further report was required to be submitted by the Secretary to the Congress by October 26, 2002.

## HOUSE BILL

The House bill adds an additional civil penalty that may be imposed on any person who violates this reporting requirement (without regard to willfulness). This new civil penalty is up to \$5,000. The penalty may be waived if any income from the account was properly reported on the income tax return and there was reasonable cause for the failure to report.

*Effective date.*—The House bill provision is effective with respect to failures to report occurring on or after the date of enactment.

<sup>511</sup> 31 U.S.C. sec. 5314.

<sup>512</sup> 31 U.S.C. sec. 5321(a)(5).

<sup>513</sup> 31 U.S.C. sec. 5322.

<sup>514</sup> A Report to Congress in Accordance with Sec. 361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, April 26, 2002.

<sup>515</sup> Sec. 361(b) of the USA PATRIOT Act of 2001 (Pub. L. 107–56).

## SENATE AMENDMENT

The Senate amendment is the same as the House bill, except the maximum additional civil penalty for a non-willful act is up to \$10,000. In addition, the Senate amendment increases the present-law penalty for willful behavior to the greater of \$100,000 or 50 percent of the amount of the transaction or account.

*Effective date.*—The Senate amendment provision is effective with respect to failures to report occurring on or after the date of enactment.

## CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

12. Regulation of individuals practicing before the Department of the Treasury (sec. 622 of the House bill, sec. 414 of the Senate amendment, and sec. 330 of Title 31, United States Code)

## PRESENT LAW

The Secretary is authorized to regulate the practice of representatives of persons before the Department of the Treasury.<sup>516</sup> The Secretary is also authorized to suspend or disbar from practice before the Department a representative who is incompetent, who is disreputable, who violates the rules regulating practice before the Department, or who (with intent to defraud) willfully and knowingly misleads or threatens the person being represented (or a person who may be represented). The rules promulgated by the Secretary pursuant to this provision are contained in Circular 230.

## HOUSE BILL

The House bill makes two modifications to expand the sanctions that the Secretary may impose pursuant to these statutory provisions. First, the House bill expressly permits censure as a sanction. Second, the House bill permits the imposition of a monetary penalty as a sanction. If the representative is acting on behalf of an employer or other entity, the Secretary may impose a monetary penalty on the employer or other entity if it knew, or reasonably should have known, of the conduct. This monetary penalty on the employer or other entity may be imposed in addition to any monetary penalty imposed directly on the representative. These monetary penalties are not to exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty. These monetary penalties may be in addition to, or in lieu of, any suspension, disbarment, or censure of such individual.

The House bill also confirms the present-law authority of the Secretary to impose standards applicable to written advice with respect to an entity, plan, or arrangement that is of a type that the Secretary determines as having a potential for tax avoidance or evasion.

*Effective date.*—The House bill modifications to expand the sanctions that the Secretary may impose are effective for actions taken after the date of enactment.

<sup>516</sup> 31 U.S.C. sec. 330.

## SENATE AMENDMENT

The Senate amendment is the same as the House bill (except for several technical drafting modifications).

*Effective date.*—The Senate amendment modifications to expand the sanctions that the Secretary may impose are effective for actions taken after the date of enactment.

## CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

13. Treatment of stripped bonds to apply to stripped interests in bond and preferred stock funds (sec. 631 of the House bill, sec. 461 of the Senate amendment, and secs. 305 and 1286 of the Code)

## PRESENT LAW

*Assignment of income in general*

In general, an “income stripping” transaction involves a transaction in which the right to receive future income from income-producing property is separated from the property itself. In such transactions, it may be possible to generate artificial losses from the disposition of certain property or to defer the recognition of taxable income associated with such property.

Common law has developed a rule (referred to as the “assignment of income” doctrine) whereby if the right to receive income is transferred without an accompanying transfer of the underlying property, the transfer is not respected. A leading judicial decision relating to the assignment of income doctrine involved a case in which a taxpayer made a gift of detachable interest coupons before their due date while retaining the bearer bond. The U.S. Supreme Court ruled that the donor was taxable on the entire amount of interest when paid to the donee on the grounds that the transferor had “assigned” to the donee the right to receive the income.<sup>517</sup>

In addition to general common law assignment of income principles, specific statutory rules have been enacted to address certain specific types of stripping transactions, such as transactions involving stripped bonds and stripped preferred stock (which are discussed below).<sup>518</sup> However, there are no specific statutory rules that address stripping transactions with respect to common stock or other equity interests (other than preferred stock).<sup>519</sup>

<sup>517</sup> *Helvering v. Horst*, 311 U.S. 112 (1940).

<sup>518</sup> Depending on the facts, the IRS also could determine that a variety of other Code-based and common law-based authorities could apply to income stripping transactions, including: (1) sections 269, 382, 446(b), 482, 701, or 704 and the regulations thereunder; (2) authorities that recharacterize certain assignments or accelerations of future payments as financings; (3) business purpose, economic substance, and sham transaction doctrines; (4) the step transaction doctrine; and (5) the substance-over-form doctrine. See Notice 95-53, 1995-2 C.B. 334 (accounting for lease strips and other stripping transactions).

<sup>519</sup> However, in *Estate of Stranahan v. Commissioner*, 472 F.2d 867 (6th Cir. 1973), the court held that where a taxpayer sold a carved-out interest of stock dividends, with no personal obligation to produce the income, the transaction was treated as a sale of an income interest.