NYSBA
New York State Bar Association
One Elk Street, Albany, New York 12207 • 518/463-3200 • http://www.nysba.org

TAX SECTION

2003-2004 Executive Committee

ANDREW N. BERG
Chair
Debevoise & Plimpton
919 Third Avenue
New York, NY 10022
212/909-6288
LEWIS R. STEINBERG
First Vice-Chair
212/474-1656
DAVID P. HARITON
Second Vice-Chair
212/558-4248
KIMBERLY S. BLANCHARD
Secretary
212/310-8799
COMMITTEE CHAIRS:
Bankruptcy and Operating Losses
Lawrence M. Garrett
Stuart J. Goldring
Compliance, Practice & Procedure
Ellis W. Reemer
Bryan G. Skarlatos
Consolidated Returns
Karen Gilbreath
Jonathan Kushner
Corporations
Kathleen L. Ferrell
Jodi J. Schwartz
Employee Benefits
Karen G. Krueger
Max J. Schwartz
Estates and Trusts
T. Randolph Harris
Jeffrey N. Schwartz
Financial Instruments
Michael S. Farber
Erika W. Nijenhuis
Financial Intermediaries
David M. Schizer
Andrew P. Solomon
Foreign Activities of U.S. Taxpayers
Peter H. Blessing
David R. Sicular
Multistate Tax Issues
Robert E. Brown
Paul R. Comeau
New York City Taxes
Robert J. Levinsohn
Irwin M. Slomka
New York State Franchise and Income Taxes
Maria T. Jones
Arthur R. Rosen
Partnerships
William B. Brannan
David H. Schnabel
Pass-Through Entities
Patrick C. Gallagher
Gary B. Mandel
Real Property
David E. Kahen
Elliot Pisem
Reorganizations
Andrew R. Walker
Diana L. Wollman
Securitizations and Structured Finance
David S. Miller
Paul R. Wysocki
Tax Accounting
David W. Mayo
Marc L. Silberberg
Tax Exempt Bonds
Stuart L. Rosow
John T. Lutz
Tax Exempt Entities
Dickson G. Brown
Michelle P. Scott
U.S. Activities of Foreign Taxpayers
Gary M. Friedman
Yaron Z. Reich

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE

Edward E. Gonzalez, Alysse Grossman, Sherwin Kamin, Arnold Y. Kapiloff, Barbara T. Kaplan, Charles I. Kingson, Janet B. Korins, Sherry S. Kraus, Jiyeon Lee-Lim, Charles Morgan, Andrew W. Needham, Deborah L. Paul, Matthew A. Rosen, Seth L. Rosen, Joel Scharfstein, Linda Z. Swartz, Gordon Warnke, David E. Watts, Victor Zonana

May 21, 2003

George K. Yin
Chief of Staff
Joint Committee on Taxation
U.S. House of Representatives
1015 Longworth
Washington, DC 20510

Dear Mr. Yin:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1032, concerning the proposed clarification of the economic substance doctrine. This Report sets forth comments of the New York State Bar Association Tax Section on the "Clarification of Economic Substance" provisions of the Jobs and Growth Reconciliation Tax Act of 2003, as reported by the Senate Finance Committee on May 8, 2003, and passed by the Senate on May 16, 2003, [1] and the nearly identical provisions of the CARE ACT of 2003, passed by the Senate on April 9, 2003 (the "Acts"). This provision is one of a number of proposals designed to target abusive tax shelter transactions.

The New York State Bar Association Tax Section has consistently supported administrative and legislative efforts to deal with the problems of corporate and other tax shelters through a number of letters and reports we have submitted during the past several years. As set out in our prior reports, we believe the fundamental problem lies with the current penalty regime, which effectively permits lawyers to write "get out of penalties free" opinions.

---

1 Title III, Subtitle A, Section 301. The final print of the Bill was not available at the time this Report was prepared.

FORMER CHAIRS OF SECTION:

Samuel Brodsky, Edwin M. Jones, Peter Miller, John E. Morrissey, Jr., Charles E. Heming, Ralph O. Winger, Martin D. Ginsburg, Peter L. Faber, Hon. Renato Beghe, Alfred D. Youngwood, Gordon D. Henderson, David Sachs, J. Roger Mentz, Willard B. Taylor, Richard J. Hiegel, Dale S. Collinson, Richard G. Cohen, Donald Schapiro, Herbert L. Camp, William L. Burke, Arthur A. Feder, James M. Peaslee, John A. Corry, Peter C. Canellos, Michael L. Schler, Carolyn Joy Lee, Richard L. Reinhold, Richard O. Loengard, Steven C. Todrys, Harold R. Handler, Robert H. Scarborough, Robert A. Jacobs, Samuel J. Dimon

Do the Public Good • Volunteer for Pro Bono

This skews the calculus of taxpayers' decisions relating to aggressive transactions. We have long supported increased strict liability penalties for tax shelters that could not be avoided through reasonable cause/legal opinion outs.

In addition to favoring increased penalties, we support, in principle, Congressional efforts to bolster the arsenal of the Treasury and the IRS in dealing with inappropriate transactions through specific changes in substantive law. Many tax shelters use common techniques (such as carrying over high-basis assets to new taxpayers) that can appropriately be curbed through legislation. We note the Proposed Legislation contains a number of specific targeted provisions that we could support, subject to technical comments.

We strongly believe, however, that the proposed codification of the economic substance doctrine is a serious mistake. The economic substance and business purpose doctrines are rules of statutory interpretation developed by the courts over the last 70 years. These doctrines are classic examples of judicially developed "common law" rules of statutory interpretation. As developed by the courts, the doctrines are applied with flexibility based upon the specific facts of the case and in light of the specific statutory provisions in issue. While there may be an occasional questionable decision in favor of the taxpayer, by and large courts generally come to the right result from a tax policy standpoint.

Attempting to codify judicially developed rules of statutory interpretation, while well-intentioned, would create serious uncertainty in many legitimate business transactions.

Many abusive transactions rely upon hyper-technical readings of the Code that lead to absurd results. Many of these transactions are already highly vulnerable to IRS attack under the economic substance and business purpose doctrines. The Proposed Legislation purportedly "clarifies" the application of the economic substance doctrine. In so doing, however, it

imposes certain conditions, which on their face would not be met by many transactions that all would agree are unobjectionable. Our Report contains an appendix with a large number of examples of straightforward non-abusive transactions, clearly permitted under current law, which are called into question by this legislation. While we expect that the drafters did not intend to change the results in a number of these examples, we have no way of knowing that from the text of the bill and accompanying explanation.

While it is true that Treasury and IRS could ameliorate the impact of the Proposed Legislation on legitimate transactions through issuance of rules and regulations, in our view this is a near impossible task. It is also unfair to have the legislation become effective in a form that is overbroad subject to the later adoption of remedial measures.

For the foregoing reasons, the New York State Bar Association Tax Section continues to support ongoing efforts to deal with abusive tax shelters but strongly opposes the codification of the economic substance doctrine.

The Report also contains certain other recommendations including alternative provisions and, if codification in inevitable, certain suggestions.

As always, we are pleased to assist Congress, Treasury and IRS in any way that we can.

Respectfully submitted,

Andrew N. Berg
Chair

cc: Mary M. Schmitt