



# 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  
212/474-1856

#### 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. Farrel  
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. Levinschn  
Irwin M. Slonka

##### 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 Piser

##### Reorganizations

Andrew R. Walker  
Diana L. Wolfman

##### Securitized and Structured

##### Finance

David S. Miller  
Paul R. Wysocki

##### Tax Accounting

David W. Mayo  
Marc L. Siberberg

##### Tax Exempt Bonds

Stuart L. Frosow  
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

Alysee Grossman  
Sherwin Kamin

Arnold Y. Kapiloff

Barbara T. Kaplan

Charles I. Kingson  
Janet B. Korins

Sherry S. Kraus

Jlyeon Lee-Lim

Charles Morgan  
Andrew W. Needham

Deborah L. Paul

Matthew A. Rosen

Seth L. Rosen  
Joel Scharfstein

Linda Z. Swartz

Gordon Wamka

David E. Watts  
Victor Zonana

May 21, 2003

The Honorable Charles E. Grassley  
Chair

Senate Finance Committee

United States Senate

135 Hart

Washington, DC 20510

The Honorable Max Baucus

Ranking Minority Member

Senate Finance Committee

United States Senate

511 Hart

Washington, DC 20510

Gentlemen:

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,<sup>1</sup> and the nearly identical provisions of the CARE ACT of 2003, passed by the Senate on April 9, 2003 (the "Acts"). This

<sup>1</sup> 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

Daie 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. Schier

Carolyn Joy Lee

Richard L. Reinhold

Richard O. Loengard

Steven C. Todrys

Harold R. Handler  
Robert H. Scarborough

Robert A. Jacobs

Samuel J. Dilon

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. 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 is inevitable, certain suggestions.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Andrew N. Berg". The signature is written in a cursive style with a large, stylized initial "A".

Andrew N. Berg  
Chair

cc: Mark Prater  
Russell W. Sullivan  
Edgar D. McClellan