



# New York State Bar Association

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May 21, 2003

The Honorable Pamela F. Olson  
Assistant Secretary (Tax Policy)  
Department of the Treasury  
Room 3120 MT  
1500 Pennsylvania Avenue, N.W.  
Washington, DC 20220

Mark W. Everson  
Commissioner  
Internal Revenue Service  
Room 3000 IR  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

Dear Assistant Secretary Olson and Commissioner Everson:

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 provision is one of a number of proposals designed to target abusive tax shelter transactions.

<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.

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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 initial 'A' and a long, sweeping underline.

Andrew N. Berg  
Chair

cc: Jeffrey H. Paravano (Senior Advisor to Assistant Secretary)  
Eric Solomon (Deputy Assistant Secretary for Regulatory Affairs)  
B. John Williams, Jr. (Chief Counsel)  
Gary B. Wilcox (Deputy Chief Counsel-Technical)  
William P. O'Shea (Acting Associate Chief Counsel-Passthroughs  
(and Special Industries)

