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New York State Bar Association

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February 18, 2004

Mr. Gregory F. Jenner
Acting 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 Acting Assistant Secretary Jenner and Commissioner Everson:

This letter concerns the revisions to the confidentiality provisions (the "Confidentiality Revisions") of the tax shelter disclosure regulations issued under T.D. 9108 on December 30, 2003.[1] We applaud the simplification achieved by the Confidentiality Revisions and are confident that they will better focus the attention of the Internal Revenue Service on transactions that may be of concern. We understand that a review of other provisions of the regulations will be undertaken to simplify them as well, and we encourage such efforts. While the

[1] This letter has been reviewed and approved by the Executive Committee of the Tax Section.

Confidentiality Revisions represent a significant improvement, some issues remain which you may want to address.

As indicated by the numerous reports we have prepared on the tax shelter issue,[2] the New York State Tax Bar Association Tax Section has consistently endorsed efforts to limit tax shelters. We commend the IRS and Treasury on their efforts in this regard and on their willingness to make modifications to address better the goal of curbing tax shelters.

The Confidentiality Revisions effectively address many of the issues that we noted in our earlier report.[3] We believe that the Confidentiality Revisions will mitigate the interference created by the earlier regulations with every-day transactions that have little or no tax avoidance issues. Transactions

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2 NYSBA Report No. 1041 (10/16/03), Letter to Hon. Charles E. Grassley and Hon. Max Baucus on tax shelter hearings; NYSBA Report No. 1039 (9/24/03), Letter to Hon. William Thomas on H.R. 2896, the *American Jobs Creation Act of 2003*, NYSBA Report No. 1033 (6/6/03), Report on Abusive Tax Shelters, NYSBA Report No. 1025 (1/7/03), Report on Proposed Tax Shelter Regulations, NYSBA Report No. 1019 (8/27/02), Report on the Tax Shelter Transparency Act (S. 2498) and the American Competitiveness and Corporate Accountability Act (H.R. 5095), NYSBA Report No. 979 (9/18/00), Letter to Hon. William V. Roth, Jr. concerning proposed legislation dealing with Corporate Tax Shelters, NYSBA Report No. 977 (7/25/00), Report on Proposal to Codify Economic Substance Doctrine

3 See Report No. 1033, supra, footnote 1.

that will generally no longer have to run the gamut of the confidentiality filter include:

- Stock, debt and other securities offerings
- Loan transactions
- M&A transactions
- Litigation settlements
- Employment agreements

The Confidentiality Revisions have narrowed the scope of the confidentiality filter by focusing on confidentiality imposed by advisors providing tax strategies. Nevertheless, as discussed in the following paragraphs, some issues remain. These include:

- Continued application of the previous confidentiality provisions to the tax shelter registration rules (section 6111)
- The meaning of the terms "advisor" and "tax strategy"
- The treatment of persons who have multiple roles in transactions
- The circumstances in which confidentiality is deemed to have been "imposed"
- The meaning of "confidentiality"

Tax Shelter Registration (Section 6111). The previous confidentiality rules continue to apply under the registration provisions.[4] We understand that these regulations were not modified for a number of reasons

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[4] Treas. Reg. § 301.6111-2(c)

including the need for other revisions to these regulations, the relatively narrow definition of "promoter", the "no reasonable basis" and "generally accepted understanding" exceptions and the expectation of congressional action with respect to the registration rules. However, having two different sets of confidentiality rules serves no policy purpose and creates unnecessary complexity in the administration of the tax laws. We understand that only a few tax shelter registrations have been received by the IRS, but suspect that this is due, in part, to the broad use of confidentiality waivers. The Confidentiality Revisions were intended to limit the need for such waivers to a more focused group of transactions. Yet, the effect of not incorporating the Confidentiality Revisions into the registration regulations will be the continued use of confidentiality waivers in numerous transactions because of uncertainty about the application of the registration requirements. We believe that the Confidentiality Revisions could be incorporated without a wholesale revision of the regulations and urge that this be done.

Meaning of "Advisor" and "Tax Strategy". These two critical terms are not defined. We take "advisor" to include a broad category of persons

who render advice to the taxpayer and thus could include attorneys, accountants, bankers, and anyone else who has a "tax strategy".

We have puzzled over whether "tax strategy", which is what must be protected to trigger the confidentiality filter, is limited to certain types of tax information. Presumably, it means more than advising with respect to well-established tax rules such as "interest is deductible" or "dividends are eligible for the dividends received deduction". One suggested formulation is that a " tax strategy" is a tax idea which an advisor has developed (or in which the advisor otherwise claims a proprietary interest) which could result in a tax benefit to the taxpayer. However, we have been unable to reach a consensus on this or any other more limited definition. If a limited meaning to the term was intended, further guidance would be helpful.

Persons with Multiple Roles. The Confidentiality Revisions indicate that in determining the fee, amounts paid to persons in their roles as parties to a transaction are not included, and give as an example, "reasonable

charges for the use of capital or the sale or use of property".[5] Some have read this provision to exclude all amounts received by a party to the transaction while others believe that amounts received by a person who is a party to the transaction that are attributable to services performed by the person, such as services for implementation of the transaction or for tax strategies, are not excluded. For example, in an investment fund organized as a limited partnership, the general partner is a party to the transaction. In addition, the general partner may receive separately stated management fees (treated as guaranteed payments for tax purposes), primarily for asset management or investment advisory services. The general partner may also provide an incidental amount of structuring advice to certain investors on formation of the fund, in light of tax, regulatory or legal considerations affecting such investors. Possible conclusions include:

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[5] ". . . A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example a fee does not include reasonable charges for the use of capital or the sale of use of property." Treas. Reg. § 301.6011-(4)(b)(3)(iv).

While the regulation focuses on the calculation of the amount of the fee, the preamble describes what appears to be a somewhat broader exclusion:

> "The IRS and Treasury Department believe that the confidentiality filter should not apply to transactions in which confidentiality is imposed by a party to the transaction acting in such capacity".

- Because the general partner is compensated as a general partner (regardless of the form of such compensation), all of its compensation is received in its capacity as a party to the transaction and is not taken into account.

--or--

- Because it receives separate management fees, the general partner has a second role in the transaction, and some or all the management fees are attributable to that second role and are not received in its capacity as a party to the transaction.

Also, is the conclusion affected by whether an affiliate of the general partner, rather than the general partner itself, performs management or advisory services for which it receives a fee?

We are concerned that a broad application of the exclusion for "parties to the transaction" could be abused to eviscerate the confidentiality filter. Obviously, a tax adviser who acquires a nominal equity interest merely to claim it was acting as a party to the transaction should not obtain more favorable treatment than a similar tax adviser without such an equity interest. On the other hand, in many conventional commercial arrangements, persons who are clearly parties to the transaction will provide services for which they are separately compensated. Where the role of a person as a party to the transaction is clear and the provision of tax strategies is incidental, the mere fact that the person receives

compensation for services should not cause such compensation to count as a fee under the regulation. Yet, even some conventional commercial arrangements may include aggressive tax strategies. If reporting of such strategies is intended under the Confidentiality Revisions, the "parties to the transaction" exclusion should be applied narrowly. The Confidentiality Revisions are not clear on this point, and we are concerned that some will be tempted to read the exclusion too broadly to exempt clearly abusive transactions. On the other hand, absent clarification of the Confidentiality Revisions, it is likely that some sponsors of investment funds, and other principals to everyday commercial transactions who also provide services, will continue to include confidentiality waivers in their documentation because of the above-described uncertainty.

Accordingly, we recommend that the Confidentiality Provisions be modified (or otherwise clarified) to confirm that the confidentiality filter does not apply to transactions in which a party to the transaction merely provides customary tax advice. This could be achieved by excluding all fees where the party has rendered no more than customary tax advice. Thus, we suggest that the following sentences be added add the end of subparagraph (b)(3)(iv):

> In addition, no amounts received by parties to the transaction are included as fees if the parties (or their affiliates) render no more than customary tax advice such as might be rendered by a general partner of an investment fund in connection with the organization of the fund or to investors in the fund. Such advice would include, for example, the treatment of a partnership as flowing through tax items or the treatment of a corporation as a separate entity for tax purposes.

"Imposed" by Advisor. This requirement is narrowly written so that if confidentiality is imposed by others or by law, this aspect of the Confidentiality Revisions will not be triggered. Thus, securities law limitations should never trigger the confidentiality provisions. Moreover, a tax strategy developed by a tax advisor for a party to an M&A transaction should not be subject to the Confidentiality Revisions merely because such party imposes confidentiality on the other party to the transaction, provided that the advisor has not imposed confidentiality on its principal.

Meaning of "Confidential". Questions have been raised concerning the circumstances in which "confidentiality" is deemed to be imposed. For example, some have suggested that confidentiality imposed for a limited period of time does not make a transaction confidential. However, we believe

that any period of confidentiality will trigger the confidentiality filter, unless the regulations are revised to provide an exception for a specific time period. On the other hand, we do not believe that the confidentiality waiver for M&A transactions that remains in the registration regulations should trigger the confidentiality filter in the Confidentiality Revisions.

Tax Opinions often provide a limitation to the following effect:

> This opinion may not be furnished to others or relied upon without our express prior written consent.

The prohibition on reliance is clearly not an imposition of confidentiality. On the other hand, while a prohibition against providing an opinion to others does not technically prevent the recipient from disclosing its contents, such prohibition is likely to have such a chilling effect that you may want to consider explicitly providing that it is a limitation on confidentiality for opinions that deal with more than the accuracy of tax discussions in offering documents.

* * *

We enthusiastically endorse the changes made in the Confidentiality Revisions. As always, we will be pleased to provide constructive

assistance in any way that we can in respect to our comments to this letter or with respect to other aspects of the overall efforts to curb tax shelters.

Respectfully submitted,

Lewis Steinberg
Chair

cc: Eric Solomon (Deputy Assistant Security for Regulatory Affairs)
Emily Parker (Acting Chief Counsel)
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