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May 5, 2006

Mr. Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3112 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Application of the IRC §§6111 and 6112
Material Advisor Rules To Law And Accounting Firms

Dear Acting Deputy Assistant Secretary Solomon and Commissioner Everson:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1109, which comments on the application of the IRC §§6111 and 6112 material advisor rules to law and accounting firms.

This report was prepared at the suggestion of Donald Korb who expressed an interest in hearing about issues arising from firms' attempts to comply with the new material advisor rules. In response, an ad hoc committee of the Tax Section conducted an informal poll of various law and accounting firms to determine how they were implementing the material advisor rules and what problems they had encountered. Our findings and proposed recommendations are set forth in the enclosed report.

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The material advisor rules were adopted as part of the American Jobs Creation Act of 2004, P.L. 108-357, Stat. 1418 (the "Act") which amended IRC §§6111 and 6112 to replace the old tax shelter registration regime with new rules that require material advisors to report and maintain lists with respect to reportable transactions. The Act also amended IRC §§6707 and 6708 to replace the penalties under the old regime with more severe penalties for failure to comply with the material advisor rules. Shortly after the Act became effective, Treasury issued Notice 2004-80, 2004-50 I.R.B. 963, to alert taxpayers to the new reporting and list maintenance requirements and to provide interim guidance regarding, among other things, the definition of who constitutes a material advisor. Treasury subsequently issued Notice 2005-22, 2005-12 I.R.B. 756, to provide additional guidance on various topics including the definition of material advisor.

We support the idea of enhanced transparency with respect to tax-motivated transactions and we commend Treasury's continuing efforts to develop and refine appropriate reporting and list maintenance requirements. Nevertheless, firms have encountered significant difficulties in attempting to implement the current material advisor rules because of the way in which the material advisor rules are applied to collective entities, such as law and accounting firms, and the ambiguity of the triggers for becoming a material advisor. Firms and other organizations are responsible for filing a report and maintaining a list with respect to any reportable transaction if any of their shareholders, partners, or employees has made any tax statement with respect to the transaction and if the fees for the transaction exceed a certain threshold. As a result, firms and other organizations are required to monitor every tax statement made by their shareholders, partners and employees to insure that the necessary reports are filed and lists are maintained in the event that the transaction about which the statement was made is or becomes a reportable transaction.

The problem is that it is very difficult for firms to monitor every tax statement made by any of its shareholders, partners, or employees with respect to every transaction that is, or may become, reportable. Thus, it is entirely possible that a firm could fail to file a report or keep a list on a timely basis with respect to a particular reportable transaction despite the firm's best efforts to stay informed of what its various shareholders, partners and employee are doing. In such case, through no fault of its own, and despite the firm's best efforts to comply with the material advisor rules, the firm could be subject to enhanced penalties that will be extremely difficult, if not impossible, to waive.

To address this problem, we recommend that the definition of when a firm becomes a material advisor be modified to incorporate a type of safe-harbor for firms that adopt certain procedures to monitor compliance with the material advisor rules.

Specifically, we recommend that Treasury adopt a definition of material advisor which provides that a material advisor is not treated as becoming a material advisor until all of the following events have occurred:

1. the material advisor makes a tax statement;

2. the material advisor receives (or expects to receive) the minimum fees;

3. the transaction is entered into by the taxpayer; and

4. with respect to a firm that has implemented adequate material advisor procedures, the designated compliance officer has actual knowledge that the first three requirements of the definition have been satisfied, unless the designated compliance officer, or any other person involved in the management of the firm, knows or has reason to know that one or more shareholders, partners or employees of the firm are engaged in a pattern or practice that does not comply with the material advisor reporting requirements set forth in IRC §§6111or 6112, or that one or more shareholders, partners or employees of the firm were so engaged and any resulting non-compliance has not been remedied.

To reduce uncertainty and provide some standards by which firms will be evaluated, we recommend that Treasury provide guidance regarding what constitutes adequate material advisor procedures. We suggest that adequate material advisor procedures be defined as a written policy that is implemented by the firm and that includes the following elements:

1. written notification and training for all of the firm's newly hired professionals, plus periodic, but no less than annual, notification and training for all professionals outlining the requirements under IRC §§6111 and 6112 as well as the procedures implemented by the firm as part of these rules and cautioning non-tax professionals to refrain from discussing tax matters with their clients;

2. the designation of at least one material advisor compliance officer within the firm who is responsible for overseeing these procedures and ensuring compliance with the reporting and list maintenance obligations of IRC §§6111 and 6112; and

3. implementation of procedures that require each tax practitioner within the firm to confirm to a material advisor compliance officer on a quarterly basis whether or not they have made a tax statement with respect to a reportable transaction.

We believe that this system achieves the best balance between the need to ensure that firms comply with the material advisor rules and the need for a system to be sufficiently flexible and practical so that it can be implemented by firms of all types and sizes.

We appreciate your consideration of our recommendations and would be pleased to discuss them with you further. We would be happy, as well, to provide any other assistance that you would find helpful.

We appreciate your consideration of our comments and would be pleased to discuss them with you further. We would be happy to provide any other assistance that you would find helpful.

Respectfully submitted,

Kimberly S. Blanchard
Chair

Cc: Michael J. Desmond, Tax Legislative Counsel,
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Donald L. Korb, Chief Counsel,
Internal Revenue Service
Stephen Whitlock, Deputy Director,
IRS Office of Professional Responsibility