NEW YORK STATE BAR ASSOCIATION

TAX SECTION

REPORT ON PROPOSED REGULATIONS AMENDING THE REPORTABLE TRANSACTION DISCLOSURE AND LIST MAINTENANCE RULES

JANUARY 22, 2007

Report No. 1126

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This report comments on the proposed regulations issued on November 2, 2006 amending the disclosure and list maintenance rules under IRC §§ 6011, 6111 and 6112 (the "Proposed Regulations").[1]

I. Introduction

The Proposed Regulations are the latest in a series of legislative and regulatory initiatives designed to enhance the disclosure and list maintenance rules for taxpayers and material advisors.[2] Transparency and disclosure of information about potentially abusive transactions is an important tool to help prevent abusive tax shelters. We commend the Treasury Department's ("Treasury's") continuing efforts to refine the disclosure and list maintenance rules in a way that will generate useful information while minimizing the burden on taxpayers, their advisors and legitimate transactions. Many of the amendments

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* This report was prepared Bryan C. Skarlatos with substantial assistance from Megan Brackney. Helpful comments were received from Kimberly Blanchard, Andrew Braiterman, Peter Blessing, Peter Canellos, Robert Cassanos, Michael Farber, Edward Gonzales, Elizabeth Kessenides, Stephen Land, Joshua Milgrim, David Miller, Alexandra Minkovich, Charles Morgan, Elliot Pisem, Michael Schler, Kirk Wallace and Diana L. Wollman.

1 *See* 71 Fed. Reg. 64488, 2006-49 I.R.B. 1049 (Nov. 2, 2006); 71 Fed. Reg. 64496, 2006-49 I.R.B. 1057 (Nov. 2, 2006); 71 Fed. Reg. 64501, 2006-49 I.R.B. 1063 (Nov. 2, 2006). At the same time, Treasury also issued temporary regulations under IRC §§ 6011 and 6111 addressing the effect a ruling request has on taxpayer and material advisor disclosure obligations. *See* 71 Fed. Reg. 64459, 2006-49 I.R.B. 1030(Nov. 2, 2006). This report does not comment on those temporary regulations.

2 *See* amendments to I.R.C. 6111and 6112 made by section 815 of The American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat.1418, 1581-83 (Oct. 22, 2004); *See also*, Temp. Treas. Reg. § 1.6011-4T (2000) (as amended by T.C. 8896, T.D. 8691, T.D. 9000 and T.D. 9017); Temp. Treas. § 301.6111-1T (1984) (as amended by T.D. 7990 and T.D. 8078); Temp. Treas. Reg. § 301.6111-2T (2000) (as amended by T.D. 8896, T.D. 8961, T.D. 9000 and T.D. 9017); Temp. Treas. Reg. § 301.6112-1T (1984) (as amended by T.D. 7990, T.D. 8875, T.D. 8896 and T.D. 9018) *and* Notice 2006-6, 2006-5 I.R.B. 385 (Jan. 30, 2006); Notice 2005-22, 2005-12 I.R.B. 756 (Feb. 24, 2005); Notice 2005-17, 2005-8 I.R.B. 606 (Feb. 22, 2005); Notice 2004-80, 2004-50 I.R.B. 963 (Dec. 13, 2004).

contained in the Proposed Regulations, such as the elimination of the book-tax difference filter, modification of the threshold amount of gross income for becoming a material advisor and clarification of the form and content for disclosures and lists will help to clarify and simplify operation of the disclosure and listing regime.

In addition, the new transaction of interest ("TOI") category will help Treasury to gather information about specific transactions that do not fall within one of the reportable transaction filters. Under current law, if Treasury becomes aware of a transaction that does not fall within one of the reportable transaction filters, the only way Treasury can require reporting and listing with respect to the transaction is to designate it as a listed transaction. However, Treasury may hesitate to designate a transaction as a listed transaction because such a designation, in addition to requiring reports and lists, creates a number of adverse consequences. Such adverse consequences include non-waivable monetary penalties for failure to disclose[3], SEC reporting of such penalties[4], suspension of the statute of limitations[5], IRS requests for tax accrual workpapers[6], limitations on the filing of qualified amended returns[7] and excise taxes for tax-exempt entities[8].

The new TOI category allows Treasury to identify a specific transaction about which it wants to collect more information without triggering the adverse consequences described above. However, depending on how broad the transactions of interest category ultimately becomes, there is a possibility that this new category will impose heavy

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3 I.R.C. § 6707A(d)(1).
4 I.R.C. § 6707A(e).
5 I.R.C. § 6501(c)(1).
6 *See* Announcement 2002-63, 2002-40 I.R.B. 644 (Oct. 7, 2002).
7 *See* Treas. Reg. 1.6664-2(c)(2).
8 I.R.C. § 4965.

burdens on taxpayers, advisors, transactions and Treasury itself. Accordingly, we have made recommendations designed to mitigate those burdens.

The revised definition of what constitutes a tax statement will also help to generate additional reports and, possibly, additional information in certain circumstances. At the same time, we have identified a potential problem with that portion of the new definition that includes statements to other material advisors and have suggested a modification of the definition.

We also have comments about the rules regarding the content of disclosure statements and lists, taxpayers' time for providing disclosure statements and the reportable transaction number.

II. Transactions of Interest

A. Summary

Treasury has proposed a new category of reportable transaction designated as "transactions of interest." A TOI is defined as

> a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation or other form of published guidance as a transaction of interest.

Prop. Reg. § 1.6011-4(b)(6).[9] The preamble to the Proposed Regulations explains that a TOI is "a transaction that the IRS and Treasury Department believe has a potential for tax avoidance or evasion, but for which the IRS and Treasury Department lack enough information to determine whether the transaction should be identified specifically as a tax

[9] The IRS and Treasury also have proposed amending the estate, gift, employment, and pension and exempt organization excise tax provisions to make those provisions applicable to transactions of interest. *See* Prop. Reg. § 25.6011-4 (gift tax), Prop. Reg. § 31.6011-4 (employment tax), Prop. Reg. § 53.6011-4 (foundation and similar excise taxes), Prop. Reg. § 54.6011-4 (pension excise taxes), and Prop. Reg. § 56.6011-4 (public charity excise taxes).

avoidance transaction." 71 F.R. 64488 (Nov. 2, 2006). Once the IRS has gathered sufficient information to determine whether a TOI is a tax avoidance transaction, it may take additional steps, including removing the transaction from the TOI category, designating the transaction as a listed transaction or creating a new category of reportable transaction.[10] *Id.* The TOI category would apply to transactions entered into on or after November 2, 2006. Prop. Reg. §1.6011-4(h).

B. Commentary

We recognize the need for the government to be able to collect information about potentially abusive transactions that do not fall within the reportable transaction filters. At the same time, we are concerned that, precisely because the new TOI category does not generate many of the adverse consequences attendant to listed transactions, Treasury will be encouraged to designate as TOIs transactions that ultimately turn out to be non-abusive simply to collect information about those transactions.

Our comments below in respect of TOIs are to a significant extent being made in a vacuum. As of the date of this Report, not a single transaction has been designated as a TOI. The language of the Preamble suggests that transaction to be designated as TOIs will be potentially abusive. Other comments made by Treasury officials, however, raise the possibility that designated TOIs may be made more for information-gathering purposes. The extent to which we have concerns over the potential designation of TOIs turns to some extent on whether the transactions so designated do in fact turn on demonstrable abuse potential.

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[10] A Treasury official explained that the "transactions of interest" filter is intended to capture transactions that the government wants to know more about, but is not necessarily a precursor to listing the transaction. *See* Sheryl Stratton, *Current and Former IRS, Treasury Officials Disagree Over OPR Procedures*, 2006 TNT 222-4 (Nov. 17, 2006).

To date, the process for listing transactions and creating the reportable transaction categories has involved significant analysis and commentary and is guided by some objective criteria other than Treasury's subjective desire to learn more about a transaction. The TOI category lowers the threshold for a reportable transaction and may open the door to more expansive and potentially less thoughtful designations of transactions as reportable transactions. Indeed, one Treasury official has recently stated that there are already at least half a dozen transactions that are of interest to the government and that are expected to become TOIs. *See* 2006 TNT 222-4.

There are no real guidelines regarding the types of transactions that will become TOIs. We recognize that some degree of ambiguity is necessary and that the creation of guidelines could restrict Treasury's ability to obtain information about a transaction. Nevertheless, this new procedure for designating TOIs has the potential to generate unfair surprise for taxpayers and advisors who suddenly learn that the transaction they are about to consummate or have already closed has become reportable. This element of surprise is magnified by the substantially similar component of the TOI definition. For example, the up-coming designation of at least half a dozen TOIs recently mentioned by the Treasury official will potentially effect many substantially similar transactions, even though taxpayers and practitioners have no idea what types of transactions are about to become reportable.

While designating a transaction as a TOI will not generate the same adverse consequences caused by listing a transaction, a TOI designation still will have a significant impact on any transaction that is the same as, or substantially similar to, the transaction that is identified. With respect to transactions that have not yet been

consummated, a TOI designation will chill the market with respect to such transactions, or any substantially similar transactions. There are many responsible taxpayers who simply do not want to be involved in a reportable transaction or a transaction that is "of interest" to the Treasury.[11] Thus, designating a transaction as a TOI will prevent taxpayers from considering such transactions, even though it ultimately may be determined that there is nothing wrong with the transaction.

Further, the chill on the market can last indefinitely because there is no time-limit within which Treasury must list the transaction, create a new category for the transaction or release the transaction from the TOI designation. Under these circumstances, a TOI designation may tarnish an otherwise legitimate transaction forever.

A TOI designation can also have an adverse impact on transactions that have already been consummated by triggering an unwind of such transactions. For example, many deal documents contain provisions that allow the transaction to be unwound (or called in the case of a debt or equity offering) if there is a "change in law," which may include a challenge or threatened challenge by the IRS to the tax treatment of the transaction or transactions that are similar to the transaction. Taxpayers may properly conclude that the designation of a transaction as a TOI amounts to a threatened challenge to the validity of the transaction, thus triggering an unwind or a call.

Even in situations where the transaction is not unwound or called, taxpayers and their advisors will be unhappily surprised to find that a TOI designation applies

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[11] One generally positive aspect of the reporting and list maintenance regime is that listed transactions have acquired a type of stigma. Many taxpayers have a written policy against engaging in any listed transaction and it appears that some malpractice insurers want to know whether their insureds provide advice with respect to listed transactions. We are concerned that this type of stigma will spill over to TOIs. In particular, the tax-exempt community is extremely wary of any transaction that may potentially be described in section 4965, given the penalties levied thereunder, and a practice has developed under which tax-exempts will not make investments in entities that might potentially run afoul of these rules. See Tax Section Report No. 1116, "Report on Section 4965" (August 25, 2006).

retroactively to require reporting and listing for transactions that were not subject to these obligations when consummated. By expanding the class of transactions that are subject to retroactive reporting and listing obligations, Treasury has compounded one of the most difficult burdens imposed by the reporting and listing regime. We recognize that it is important for Treasury to be able to collect information about deals that have already been consummated. And to the extent that TOI designations are limited to transactions that clearly have the potential for abuse, it can be argued that taxpayers who entered into such transactions should have no detrimental reliance expectations. Nevertheless, it is unclear that TOIs will always be aimed only at clearly abusive transactions, and it may be onerous to impose these obligations on taxpayers and advisors retroactively with respect to transactions that Treasury has not yet determined are abusive.

Indeed, all of these negative consequences, chilling the market, potential unwinds and retroactive reporting and listing obligations may be appropriate with respect to abusive transactions. However, the TOI category includes transactions in which Treasury is interested even though they have not been determined to be abusive. On balance, it can be excessively disruptive and burdensome to impose these negative consequences on legitimate transactions simply because Treasury wants to collect more information about the transactions. Such consequences should be imposed only after Treasury has made an affirmative finding that a transaction is, in fact, abusive.

Of course, the level of our concern regarding these issues depends on the process for designating a TOI and the number and types of transactions that ultimately are designated. If TOI designations are made sparingly and are targeted to truly abusive transactions that are described precisely and narrowly, and taxpayers have some security

that regular commercial transactions will not suddenly become reportable, then the adverse affects of the TOI category will be limited. In contrast, if the designations are made liberally, or the subject transactions are not described with precision or large numbers of taxpayers and practitioners are surprised to learn that their transactions have become reportable, then it is more likely that the burdens imposed by the new TOI category will outweigh the intended benefits.

C. Recommendation

We have a number of recommendations that Treasury should consider to help mitigate the adverse impact that TOI designations could have on legitimate transactions. First, we suggest that Treasury provide more guidance about what types of transactions could become TOIs. The current definition of a TOI simply states that a transaction is a TOI if Treasury says it is a TOI. *See* Prop. Reg. § 1.6011-4(6). While we recognize that it is impossible to provide specific criteria in the regulations with limiting Treasury's ability to collect information, the current definition is essentially meaningless. To address this concern, we recommend that the following explanation from the preamble be set forth in the body of the regulations:

> A transaction of interest is a transaction that the IRS and Treasury Department believe has a potential for tax avoidance or evasion, but for which the IRS and Treasury Department lack enough information to determine whether the transaction should be identified specifically as a tax avoidance transaction.

71 F.R. 64488 (Nov. 2, 2006).

Next, and most importantly, we suggest that once Treasury has identified a transaction that is believes has a potential for tax avoidance or evasion, Treasury publish advance guidance notifying taxpayers that it is considering designating the transaction as

a TOI and requesting comments. Such advance notice will provide a mechanism through which taxpayers and practitioners can comment on and supply further information about subject transactions. This will assist Treasury to better understand the transaction, and substantially similar transactions, and determine whether the proposed TOI designation should be modified, expanded or eliminated. In some cases, Treasury may obtain more information about the transaction in the notice period than it would merely by designating the transaction without advance notice. Advance notice and comment will also help Treasury to avoid designating a transaction that will generate a flood of useless reports.[12] The advance notice will also alert taxpayers about the types of transactions that are about to become reportable and will give them an opportunity to evaluate the obligations they will incur if they proceed with a particular transaction.

In addition, we recommend that a TOI designation be limited to a finite period of time, such as twenty-four months, unless Treasury acts to extend the designation for an additional twenty-four month period. The number of such additional extensions could be unlimited as long as an extension requires some affirmative act by Treasury. By limiting the time-period for the designation, Treasury will be motivated to evaluate the transaction within the twenty-four month period to determine whether the transaction should be listed, should become part of a new reportable category, or should be proactively released from the TOI designation. Such a rule will mitigate the chilling affect that a TOI designation will have on legitimate transactions.

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[12] It seems that Treasury would wish to avoid the type of disruption in the marketplace that occurred when it listed a transaction involving a notional principal contract in Notice 2002-35. Many taxpayers and advisors believed that this notice covered common transactions such as total return swaps, resulting in the filing of thousands of disclosures and the ultimate issuance of Notice 2006-16 to correct the problem.

Finally, Treasury should consider restricting the retroactive period for TOI designations to a limited time-period, such as twenty-four months. This modification to the Proposed Regulations will reduce the number of situations in which a TOI designation gives rise to an unwind or call and will reduce the number of taxpayers and advisors who are unfairly surprised to learn that transactions they were involved with years ago have suddenly become reportable. Of course, Treasury can chose at any time to impose unlimited retroactivity simply by listing the transaction. Thus, there will be no restriction on Treasury's ability to gather information retroactively in appropriate cases.

III. Definition of Tax Statement

A. Summary

Each material advisor with respect to any reportable transaction is required to file a report and maintain a list with respect to the transaction. I.R.C. §§ 6111 and 6112. Under the current rules, a practitioner can become a material advisor only by making a tax statement to a taxpayer. *See* Treas. Reg. § 301.6112-1(c)(2)(i). Typically, practitioners make tax statements only to taxpayers who are their clients. Thus, under the current rules, practitioners who become material advisors are obligated to file reports and keep lists only with respect to transactions entered into by their clients. *See* Treas. Reg. § 301.6112-1(c)(2)(i). Though it may be difficult, it is usually possible to explain the reporting and listing obligations to a client and obtain the necessary information for the reports and lists.

The Proposed Regulations significantly expand the scope of what constitutes material aid or assistance by including tax statements made by practitioners to material advisors. Prop. Reg. §§ 301.6111-3(b)(2)(i)(C) and (D). In certain circumstances, this

new definition of tax statement will enlarge the class of people with respect to whom a practitioner must file a report and keep a list to include taxpayers who are adverse to the practitioner and about whom the practitioner has no information. Requiring practitioners to file reports and maintain lists with respect to transactions entered into by taxpayers who do not have some type of relationship with the practitioner will create problems because it will be awkward, difficult and sometimes impossible for practitioners to obtain the necessary information.

B. Commentary

We believe that the expansion of the definition of what constitutes a tax statement was intended to encompass situations in which several material advisors representing the same taxpayer speak to each other, whether or not each of them speaks directly to the ultimate taxpayer. For example, there are transactions that involve several attorneys, accountants and investment bankers who represent the same taxpayer and who speak among each other even though only one or two of the advisors speak directly to the taxpayer/client. In situations like this, the Proposed Regulations will cause several of the advisors to become material advisors who have to file reports and keep lists with respect to the transaction. We do not have any particular concern with the operation of the rule in this context, though we do point out that it requires the filing and maintaining of duplicate reports and lists, generating additional burdens that may not be balanced by any incremental benefit to the Treasury.

Problems arise, however, in situations that involve practitioners and other advisors who represent taxpayers on opposite sides of a negotiated transaction.[13] It is

[13] Although the material advisor rules are generally aimed at what most would consider to be "tax shelter" transactions, the filters employed by the reportable transaction rules invariably cast a wider net, picking up

entirely possible for a practitioner representing a taxpayer on one side of a transaction to make a tax statement to a practitioner representing the taxpayer on the opposite side of a transaction. A practitioner negotiating a deal may make assertions regarding the other party's tax treatment if it has a bearing on the structure of the overall transaction. For example, a practitioner negotiating a purchase of an asset on behalf of a buyer may discuss the allocation of the purchase price with the seller's advisors and, if the sale constitutes a loss transaction for the seller, the practitioner will have become a material advisor with respect to the loss transaction because the practitioner has made a tax statement to another material advisor. Situations like this will create a number of difficulties.

First, a practitioner may not be capable of evaluating whether the person he or she is speaking with is, or is not, a material advisor. That determination turns on a number of factors, including what the potential material advisor earns in fees, and such information may not be obtainable by the person making the statement. Second, a practitioner may not be privy to much of the information about the taxpayer on the other side of the deal that is required to be reported or listed. Some of the information regarding the transaction that is required to be reported includes the expected tax treatment of the transaction, the tax benefits expected from the transaction, any tax result protection the taxpayer may have obtained and the identities of all the material advisors involved in the transaction. Prop. Reg. § 301.6111-3(d)(1). The list regarding the transaction must include a summary of the tax treatment each person is expected to derive from the transaction and copies of documents material to an understanding of the tax treatment or

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innocent transactions that, for example, generate large economic losses. Thus, the material advisor rules can and do apply to ordinary two-party commercial transactions.

structure of the transaction that were provided or shown to any person who acquired an interest in the transaction. Prop. Reg. § 301.6112-1(b)(3). A practitioner on one side of a transaction does not necessarily have access to this type of sensitive information about the taxpayer on the other side of a transaction. Indeed, taxpayers on opposite sides of a transaction may have adverse interests and may refuse to provide such information.

In addition, it will be extremely awkward and potentially disruptive to the process of negotiating and consummating a transaction to require practitioners to extract information from, and file reports and maintain lists about, taxpayers who are not their clients. As noted above, taxpayers on opposite sides of a transaction may be adverse and the type of communication between a material advisor and a client that is necessary to comply with the reporting and listing obligations may not be possible in this context. Moreover, the taxpayers and/or advisors on opposite sides of a transaction may have different opinions regarding whether the transaction is reportable. Indeed, the Proposed Regulations may actually increase the adversarial nature of some negotiations by causing material advisors to be more circumspect in the information they provide and the statements they make to advisors on the other side of a transaction out of concern that such communications could either put someone on notice that a transaction is reportable or that the communication could be construed as a tax statement.

More complications may arise if a practitioner has a continuing obligation to monitor a transaction. A practitioner who ceases providing services before a transaction is consummated must make reasonable and good faith efforts to determine when the transaction is entered into. Prop. Reg. § 301.6111-3(b)(4)(ii). Similarly, a practitioner must continue to monitor a transaction to determine if it is designated as a listed

transaction or TOI after the date on which it is consummated. Prop. Reg. § 301.6111-3(b)(4)(iii). It will be virtually impossible for a practitioner to fulfill these on-going obligations with respect to taxpayers who are not clients of the practitioner.

C. Recommendation

We recommend that the Proposed Regulations be modified to provide that a practitioner provides material aid or assistance only by making a tax statement to (a) a taxpayer who is a direct or indirect client of the practitioner, or (b) a taxpayer who purchased or otherwise obtained a tax strategy from the practitioner or a direct or indirect client of the practitioner, or (c) another material advisor of such taxpayer. A taxpayer would be a direct or indirect client of a practitioner or material advisor if the practitioner or material advisor derives fees directly or indirectly from the taxpayer, or a person who is compensated by the taxpayer, for services with respect to the transaction.[14]

Such a rule will continue to generate reports and lists from material advisors on one side of a transaction but will eliminate the need for a practitioner to obtain information from, report and list information about, and monitor transactions of, taxpayers with whom the practitioner has no relationship. At the same time, this rule should not create a substantial risk that Treasury will lose material information because in most, if not all, cases, the same information is required to be reported by material advisors on the other side of the transaction.

For purposes of clarity, we suggest that the Proposed Regulations include some examples of the types of situations in which a material advisor who makes a statement to

[14] This language is similar to the language used for the gross income threshold in Prop. Reg. § 301.6111-3(b)(3)(ii).

another material advisor will be considered to have made a tax statement. Some suggested examples are set forth below.

> Example 1. A taxpayer hires an attorney A and an accountant B to help structure a transaction that is reportable under Prop. Reg. § 1.6011-4(b). Attorney A hires accountant C to assist with respect to one aspect of the transaction. Attorney A and accountants B and C all receive gross income directly or indirectly in excess of the threshold amounts in Prop. Reg. § 301.6113-3(b)(3). Accountant C never speaks directly to the taxpayer. However, accountant C makes a tax statement to attorney A. Accountant C is a material advisor with respect to the transaction entered into by the taxpayer.
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> Example 2. An investment bank sells a reportable transaction to a taxpayer. The investment bank's attorney makes a tax statement to the taxpayer's attorney. Both attorneys receive gross income directly or indirectly in excess of the threshold amounts in Prop. Reg. § 301.6113-3(b)(3). The investment bank's attorney is a material advisor with respect to the transaction entered into by the taxpayer.
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> Example 3. Taxpayer A hires attorney B to help negotiate the purchase of an asset from Taxpayer X. Taxpayer X is represented by attorney Y in the transaction. The transaction is a reportable transaction because Taxpayer X will recognize a loss of the kind described in Temp. Reg. § 1.6011-4(b)(5). Both attorney B and attorney Y receive gross income directly or indirectly in excess of the threshold amounts in Prop. Reg. § 301.6113-3(b)(3). Attorney B makes a tax statement to attorney Y. Attorney B is not a material advisor with respect to the transaction simply by virtue of the tax statement to attorney Y.

IV. Content of Disclosure Statements and Lists – All Tax Benefits

The Proposed Regulations clarify that, to be considered complete, disclosure statements must describe the expected tax treatment and all potential tax benefits expected to result from "the transaction." Prop. Reg. §§ 1.6011-4(d) and 301.6111-3(d)(1). The Proposed Regulations relating to the content of material advisor lists similarly requires a summary of the expected tax treatment from participation in "each reportable transaction." Prop. Reg. § 301.6112-1(b)(3)(i)(E). The regulations define transaction to include "all of the factual elements relevant to the expected tax treatment of

any investment, entity plan or arrangement, and includes any series of steps carried out as part of a plan." Prop. Reg. § 301.6011-4(b)(1).

It is not clear whether the tax treatment or benefits from the "transaction" referred to in these regulations means every tax result flowing from the transaction to every taxpayer who entered into the transaction or only those tax treatments or benefits that caused the transaction to be a reportable transaction with respect to a particular taxpayer. To the extent that these provisions require the reporting and listing of tax consequences that have nothing to do with tax aspects of the transaction that caused the transaction to be listed in the first place, the provisions are overbroad.

Many transactions generate a myriad of tax consequences and potential tax benefits, only a few of which have anything to do with the reportable transaction rules. For example, a normal M&A transaction or a transaction arising from a bankruptcy may trigger the loss transaction filter or may be substantially similar to a listed transaction or a TOI. Such transactions probably will have numerous tax consequences that have nothing to do with the reason why the transactions are reportable and it would be unduly burdensome and would generate very little benefit to require the reporting and listing of all these tax consequences. Accordingly, we recommend that the Proposed Regulations be amended to clarify that taxpayers and material advisors are required to disclose and list only those tax consequences or benefits that cause the transaction to be reportable.

Moreover, for the reasons described in section III.B above, it would be difficult and often impossible to require taxpayers and material advisors to describe the tax benefits expected by a taxpayer on the other side of a transaction. Thus, we suggest that the Proposed Regulations clarify that taxpayers are required to report only those tax

consequences or benefits that relate to themselves and that material advisors are required to report and list only those tax consequences or benefits that relate to a taxpayer who (a) is or was a direct or indirect client of the material advisor, or (b) purchased or otherwise obtained a tax strategy from a direct or indirect client of the material advisor.

V. Content of Disclosure Statements and Lists – Material Advisors

The Proposed Regulations require that, to be considered complete, a material advisor's disclosure statement must contain "the identity of the material advisors" and a material advisor's list must contain "[t]he name of each material advisor to the transaction, if known by the material advisor." Prop. Reg. §§ 301.6111-3(d)(1) and 301.6112-1(b)(3)(i)(F). This language could be construed to mean that a material advisor must disclose and list the identity of other material advisors to the taxpayer on the other side of a transaction. For the reasons described in section III.B above, we believe that it will be difficult or even impossible for a material advisor to obtain information from or about taxpayers who have no relationship to the material advisor. Thus, we recommend that the Proposed Regulation be clarified to require the disclosure and listing of only those material advisors who have received fees directly or indirectly from a taxpayer who (a) is or was a direct or indirect client of the material advisor, or (b) purchased or otherwise obtained a tax strategy from a direct or indirect client of the material advisor.

In addition, there may be circumstances in which a material advisor's own client refuses to disclose to the material advisor the identities of other advisors who have been consulted in connection with a transaction. Accordingly, the disclosure rule referenced above should be amended to conform to the listing rule, which states that a material

advisor must provide the identity of other material advisors only if the material advisor has actual knowledge of such other material advisors.

VI. Content of Material Advisor Lists - Documents

The Proposed Regulations require a material advisor to include as part of a list copies of any documents material to an understanding of the tax treatment or structure of a transaction that were shown or provided to any person who acquired or may acquire an interest in the transaction. Prop. Reg. § 301.6112-1(b)(iii)(B). This language could be construed to mean that a material advisor must provide copies of documents shown or provided to taxpayers on the other side of a transaction. For the reasons described in section III.B above, we believe that the Proposed Regulations should be amended to clarify that a material advisor must include as part of a list only those documents that were provided or shown to (a) a taxpayer who is a direct or indirect client of the practitioner, or (b) a taxpayer who purchased or otherwise obtained a tax strategy from the practitioner or a direct or indirect client of the practitioner, or (c) another material advisor of such taxpayer.

The language of this regulation also could be interpreted to mean that a material advisor has an obligation to obtain copies of documents not already within the material advisor's possession. It would be excessively burdensome to require material advisors to attempt to acquire copies of documents that are not within their possession for purpose of keeping such documents are part of a list. Thus, we recommend that the regulation be clarified to require production of only those documents within the possession of the material advisor.

VII. Time for Providing Disclosure

The Proposed Regulations contain a special timing rule for taxpayers in partnerships, S corporations or trusts who receive a timely schedule K-1 less than ten days before the taxpayer's return is due. In such cases, if the taxpayer determines that the taxpayer participated in a reportable transaction based on the K-1, then the taxpayer's disclosure statement will not be considered late if it is filed with OTSA within 45 calendar days after the due date of the taxpayer's return. Prop. Reg. § 1.6011-4(e)(1). However, the Treasury has not provided guidance for taxpayers who receive a late K-1 after their return is due. We recommend that Treasury provide a rule that, in such case, if the taxpayer determines that the taxpayer participated in a reportable transaction based on the late K-1, then the taxpayer's disclosure statement will not be considered late if it is filed within 45 calendar days after receipt of the late K-1.

VIII. Reportable Transaction Number

The Proposed Regulations provide that the IRS will issue a reportable transaction number with respect to a disclosed reportable transaction to a material advisor and that the material advisor must provide the reportable transaction number to all taxpayers and material advisors to whom the material advisor makes or provides a tax statement. Prop. Reg. § 301.6111-3(d)(2). Taxpayers, in turn, must include the reportable transaction number on any disclosure that they are required to make with respect to the transaction. Prop. Reg. § 1.6011-4(d).

The issuance of reportable transaction numbers to material advisors who must then provide them to taxpayers to be filed with the taxpayers' disclosures is based on the old rules regarding tax shelter registration numbers. See Temp. Reg. § 301.6111-1T.

These old rules were motivated by, and targeted primarily to, marketed tax shelters. The issuance of a registration number that had to be provided to and reported by each taxpayer was designed to help Treasury track the proliferation of marketed shelters throughout the market.

While we recognize that it is important for Treasury to be able to track the spread of marketed transactions, we are concerned that, in certain circumstances involving non-marketed transactions, the use of a reportable transaction number may unjustifiably infringe upon the attorney-client relationship in purely one-on-one, non-abusive transactions. Treasury has a record of each number issued to each material advisor. When taxpayers file a disclosure with that number, it is a relatively easy matter for the government to match the number provided to a material advisor with the number reported by the taxpayer. At that point, the government will know that the taxpayer was a client of the material advisor and that the material advisor provided advice to that taxpayer with respect to the transaction at issue. This process eliminates any expectation of confidentiality that a taxpayer may have had regarding the taxpayer's identity, the fact that the taxpayer obtained tax advice from the material advisor with respect to the transaction and that the taxpayer consummated the transaction.[15]

In cases involving marketed transactions, the government's need to learn about and monitor marketed transactions justifies the government's intrusion into the relationship between the taxpayer and the advisor and the resulting infringement on the taxpayer's expectation of confidentiality. However, the same rules also apply to transactions that are entered into by a single taxpayer for non-tax reasons yet nevertheless

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[15] While this information may not always be subject to the attorney client privilege, it nevertheless falls within the realm of confidential information and is subject to a legitimate expectation of confidentiality.

get caught by a reportable transaction filter. In such cases involving a single taxpayer and a single transaction, the filing of the registration number will immediately reveal the identity of the client, the fact that the client entered into the transaction and the fact that the client obtained tax advice from the material advisor with respect to the transaction.

We do not believe that the violation of the taxpayer's expectation of confidentiality is justified in situations that do not involve marketed transactions. Accordingly, we suggest that the rules providing that a reportable transaction number will be issued to a material advisor and requiring a material advisor to provide the number to the taxpayer be modified so that they apply only in situations involving marketed transactions.