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A year ago to the day, B. John Williams, Chief Counsel for the Internal Revenue Service, spoke to this group and described the actions the IRS is taking to combat promoted abusive tax avoidance transactions. That speech became known as the "Alamo Speech" because of his references to The Alamo. That speech also gained attention because of his statements regarding claims of attorney-client and tax practitioner privileges by promoters of potentially abusive tax shelters.

When I was asked to appear today, I resisted entitling my speech "Return to the Alamo." I always want to be the "star," and B. John's speech a year ago is not an act that I wanted to follow. I know that my statements today cannot have the impact of his speech. As a native Texan, however, I could not resist this invitation and the chance to return to the Great State of Texas to "Remember The Alamo."

Over the last year, the IRS has continued to take actions to identify, discourage and audit abusive tax avoidance transactions. Today, I will summarize some of our actions and, in particular, our response to claims of attorney-client and tax practitioner privilege that have been asserted by promoters and their customers in the course of promoter audits.

Over the last twelve months, we have identified six abusive transactions as "listed transactions." As of today, the IRS and Treasury have identified a total of 25 "listed transactions." You can expect additional transactions to be added to this list in the near future.

Of course, "listed transactions" also expressly include transactions that are "substantially similar" to listed transactions. One of the problems we face is that taxpayers and their representatives continue to construe narrowly the phrase "substantially similar," despite the express terms of the tax shelter regulations. Therefore, we may list transactions that appear to be similar to other listed transactions. But, we will list transactions only where appropriate to alert taxpayers, their advisors and IRS agents that the transactions are abusive. We also will continue to issue published guidance outside of the tax shelter area to clarify and confirm the tax law for taxpayers and their advisors.

That the IRS and Treasury have not identified a transaction as a listed transaction, however, does not mean that the transaction works. There are many reasons why a particular transaction may not be listed. The failure of the IRS to identify a transaction as an abusive transaction should not, in any way, be viewed as approval.

In addition to identifying abusive transactions as "listed transactions," we have taken other actions over the last twelve months to discourage taxpayers from participating in abusive tax avoidance transactions.

Shortly after B. John spoke here, in Announcement 2002-63, the IRS changed its policy regarding requests for tax accrual workpapers to help shut down abusive tax avoidance transactions by corporate taxpayers. Under this new policy, the IRS may request tax accrual workpapers when it audits returns that claim a tax benefit from a listed transaction as of the date of the request. For returns filed on or after July 1, 2002, where the transaction was disclosed, these requests will apply only to tax accrual workpapers pertaining to the listed transaction. If the listed transaction was not disclosed, the IRS will routinely request all tax accrual workpapers. If the return reflects multiple listed transactions or if there are reported financial irregularities, the IRS in its discretion may request all tax accrual workpapers even if the transactions were disclosed. For returns filed prior to July 1, 2002, the IRS will request tax accrual workpapers pertaining to a listed transaction, only if the taxpayer had an obligation to disclose and failed to do so.

The IRS has the legal right to obtain tax accrual workpapers. Such workpapers, whether in the hands of the taxpayer or its independent auditor, are not privileged communications or work product since they are prepared in connection with the taxpayer's disclosure of its financial condition to third parties. See United States v. Arthur Young & Co., 465 U.S. 805 (1984). Shortly after the Supreme Court's decision in Arthur Young, the IRS announced that it would continue its policy of requesting tax accrual workpapers only in "unusual circumstances" and only with high level management approval. Announcement 2002-63 makes clear that IRS existing policies and procedures for requesting tax accrual workpapers otherwise continue to apply. We realize the potential adverse impacts of regular requests for tax accrual workpapers, but we feel that listed transactions – especially undisclosed listed transaction – present the kind of "unusual circumstances" that warrant a change in our policy.

To date, we have not seen a significant increase in IRS requests for tax accrual workpapers. That is not surprising since, for returns filed before July 1, 2002, Announcement 2002-63 only applies to listed transactions that were required to be disclosed but were not. I cannot predict whether the IRS will request tax accrual workpapers pursuant to Announcement 2002-63 large numbers of cases in the future. That is because one of the purposes of the change in the IRS policy regarding requests for tax accrual workpapers is to cause corporate decision makers to "think twice" before participating in transactions that are or may become listed transactions. The risk that participation in abusive transactions will result in requests for tax accrual workpapers should change the risk reward analysis regarding participation in such transactions in the future. Where Announcement 2002-63 applies, the IRS will not hesitate to request tax accrual workpapers.

Another way we hope to deter taxpayers and their advisors from investing in and promoting abusive transactions is through early warning. We want to stop the abuse

before it starts. Therefore, the early identification of potentially abusive transactions is a high priority for the IRS and Treasury.

In February, we issued final regulations under sections 6011 and 6112 to improve and enhance the disclosure of potentially abusive transactions by taxpayers, the registration of those transactions by "material advisors" (also sometimes known as "promoters"), and the maintenance of customer lists by those advisors. These regulations are designed to improve our web of information about potentially abusive transactions, and those who market and invest in them in particular, by requiring taxpayers to disclose "reportable transactions" on their returns and to the Office of Tax Shelter Analysis. A reportable transaction may be an abusive tax avoidance transaction.

Under current law, there is no express penalty imposed upon a taxpayer for failure to disclose a reportable transaction. Treasury has proposed legislation to impose a penalty for failure to disclose reportable transactions and there are several competing bills pending before Congress that would impose such a penalty.

Section 6662 currently imposes an accuracy-related penalty for underpayments of tax -- including underpayments due to negligence and disregard of rules and regulations and underpayments that are "substantial." Taxpayers can avoid these penalties if they can establish that there was reasonable cause for the underpayment and that they acted in good faith within the meaning of section 6664(c). The IRS and Treasury believe that taxpayers have improperly relied on opinions or advice issued by tax advisors to establish reasonable cause and good faith to avoid the accuracy-related penalty, even when the opinion or advice relates to a reportable transaction that the taxpayer did not disclose pursuant to the section 6011 regulations. Taxpayers also have improperly relied upon opinions or advice that a regulation is invalid without disclosing on their returns their position that the regulation is invalid.

On December 30, 2002, the IRS and Treasury issued proposed regulations under sections 6662 and 6664 to address these concerns. These proposed regulations provide, in part, that: (1) the adequate disclosure exception to the negligence and disregard of rules and regulations penalty under section 6662 will not apply unless the reportable transaction is also disclosed under the section 6011 regulations; (2) a taxpayer who takes a position that a regulation is invalid cannot rely on an opinion or advice to satisfy the reasonable cause and good faith exception under section 6664(c) if the position was not disclosed on a return; and (3) a taxpayer who engages in a reportable transaction cannot rely on an opinion or advice to satisfy the reasonable cause and good faith exception under section 6664(c) if the transaction was not disclosed pursuant to the section 6011 regulations. The proposed regulations further provide that a taxpayer who engages in a reportable transaction cannot rely on the "realistic possibility" standard under section 6662 to avoid the penalty for negligence or disregard of rules or regulations, if the position is contrary to a revenue ruling or notice.

We have received very few comments on these proposed regulations. One comment is that, in the absence of disclosure, the proposed regulations in effect impose strict liability for a penalty upon a taxpayer that takes a position contrary to a revenue ruling or notice or that a regulation is invalid. The concern is that a taxpayer may not even know that, in preparing the return, the return preparer has taken a position contrary to a revenue ruling or notice or that a regulation is invalid. Our general intent was that a taxpayer should not be able to rely on an opinion or advice to establish reasonable cause and good faith in the absence of disclosure, where the taxpayer has obtained an opinion or advice that its position is contrary to a revenue ruling or notice or a regulation even where the opinion or advice states that the taxpayer's position has a realistic possibility of success or that the regulation is invalid. We expect to address this and other concerns regarding these proposed regulations and proceed to issue final regulations in the near future.

Another very important part of the IRS actions to combat abusive tax avoidance transactions is audits of promoters' compliance with the registration and list maintenance requirements of sections 6111 and 6112. The IRS has approved 95 entities for promoter examinations under sections 6111 and 6112. There are currently 79 active audits; 13 are approved but not yet started; and 3 examinations have been closed or discontinued. We have issued 245 summonses to 29 promoter entities. Promoters under examination include accounting firms, law firms, insurance companies, brokerage companies, banks and other boutique and mid-size promoters. The Tax Division of the Justice Department has filed enforcement actions against 4 promoters to date, and more enforcement actions are likely. We have shown that we are willing to use the tools that we have to obtain the information to which we are entitled. You can expect our efforts to continue.

In order to audit a promoter's compliance with the registration and list maintenance requirements of sections 6111 and 6112 and to calculate any applicable penalty for failure to register and maintain a list of investors, the IRS needs information and documents regarding the promoted transactions. This includes a list of the persons who purchased an interest in each potentially abusive tax shelter as required by section 6112. Some promoters have given us the information to which we are entitled under the Code, including customer names. And, when we get that information, we are using it to audit the investors. In other promoter audits, however, the promoters and/or the investors have claimed attorney-client and section 7525 privilege for the identity of the investors, despite the list maintenance requirements of section 6112. In those cases, the IRS refers the summons to the Tax Division for enforcement.

I cannot comment on the issues or the facts of the summons enforcement cases that are currently pending in court. In any event, I am sure that the panel that immediately follows my speech will discuss those cases in some detail. However, I can confirm that we continue to hold the views on privilege that the Chief Counsel shared with you a year ago.

Our position regarding these claims of "identity privilege" is reflected in the final tax shelter regulations that were issued in February 2003. Those regulations make clear that even where an attorney or federally authorized tax practitioner has a reasonable belief that information required to be maintained under the list maintenance regulations is protected by privilege, the attorney or tax practitioner must still maintain the list. The regulations also make clear that when the list is requested by the IRS, a privilege claim is not appropriate with respect to the identity of the investor. In these circumstances, even if a lawyer-client relationship exists, the identity of the promoter-lawyer's client is not privileged because disclosure of the client's identity is required and disclosure of the client's identity does not disclose an otherwise privileged communication.

Under the regulations, any claimed privilege must be supported by a statement that is signed by the attorney or federally authorized tax practitioner under penalties of perjury. This statement (or "privilege log") must identify and describe each document that is not produced so that the IRS can determine if the privilege applies. This statement also must include specific descriptions and representations for each document for which privilege is claimed.

The IRS has taken many actions to combat abusive tax avoidance transactions over the last twelve months. I have summarized only a few of these actions. Based on anecdotal reports, the widespread promotion and participation in abusive tax avoidance transactions may have declined over the last year. Of course, we would like to take credit for that, but we know that, if this is true, it may be because there is less income and gain to shelter. We also believe, however, that IRS promoter examinations have reduced the supply and the demand for tax shelters to some degree. Both promoters and their customers appear to recognize the increased risk of detection and audit of tax returns claiming tax benefits from abusive tax avoidance transactions.

We will continue to challenge attempts to prevent the IRS from identifying and auditing taxpayers who have participated in promoted abusive tax shelters. We still believe that neither attorney-client privilege nor the tax practitioner privilege protects the identity of taxpayers who participated in such transactions. We will use our summons powers and information from promoter audits to identity investors in potentially abusive tax shelters so that we may audit those investors. When a lawyer or another federally authorized tax practitioner is acting as a promoter, their customers are just that, customers and not clients. Further, in this circumstance, disclosure of the taxpayer's identity does not disclose any otherwise privileged communication, even if the investors are clients rather than customers. The lawyer-client relationship itself is not privileged, since any number of third parties know of that relationship. Likewise, the taxpayer's participation in a tax shelter is not privileged. A taxpayer has no expectation that his participation in a tax shelter will be confidential because third parties clearly know of his participation and, in order to achieve the purpose of such transaction, the benefits must be claimed on a return. Where a taxpayer must file a return to claim the tax benefits arising from the transaction, the link between the taxpayer and the transaction cannot be privileged even where that link is through tiered partnership and trust returns.

To paraphrase the great philosopher, Yogi Berra, "the attorney-client privilege is never what it used to be." It is extremely difficult to satisfy all of the elements for application of the attorney-client privilege and the privilege is easily waived. Prior to joining the IRS, I often spoke and wrote on the attorney-client privilege. I always reminded my audience that the privilege never applies when you really need it. In that statement, I was usually referring to the crime fraud exception, but that statement equally applies to claims of identity privilege by promoters and investors in potentially abusive tax shelter transactions.

Some have asserted that our actions against promoters over the past year are an attack on tax professionals and undermine the attorney-client privilege and the section 7525 privilege. I disagree. Very few tax professionals are personally engaged in the promotion of abusive tax avoidance transactions. Most tax professionals have watched with alarm the marketing of such transactions to both individual and corporate taxpayers. Many tax professionals have urged the IRS to pursue both the promoters and investors in these transactions because the existence of this market undermines the tax system. Tax professionals who advised that these abusive transactions did not work often were criticized as being too conservative by their clients and potential clients and by the promoters. To put it bluntly, our actions to audit promoters and investors in potentially abusive tax shelters are essential to preserve the role of responsible tax advisors in the voluntary compliance system. Responsible tax professional should and do applaud our actions.

Likewise, our actions do not undermine the attorney-client privilege or the tax practitioner privilege. The attorney-client privilege and the related section 7525 privilege exist because of society's interest in encouraging clients to seek legal advice so that they can comply with the law. The underlying assumption is that if clients are encouraged to seek legal advice and provide their lawyers with all of the relevant facts, lawyers will be better able to advise clients to comply with the law. Thus, these privileges apply to the traditional lawyer-client relationship, where the client provides the lawyer with facts so the lawyer can advise the client regarding the law. Tax shelter promoters create the facts and provide those facts to the client, along with a "cookie cutter" opinion that states that "more likely than not" the tax benefits will be realized, assuming that the client has a bona fide business purpose for the transaction. Neither the purpose of the attorney-client privilege nor the traditional tests for the existence of privilege apply in this situation. Further, section 6112 expressly requires promoters of potentially abusive tax shelters to maintain and provide lists of investors to the IRS, so Congress has expressed its intent that the identity of such investors is not privileged. Our position that privilege does not apply in this context does not undermine the application of privilege to communications by clients to lawyers in the traditional lawyer-client context, if the other requirements for application of the privilege are satisfied.

When the Chief Counsel spoke here last year, he referred to the three most famous battles of the Texas Revolution: The Alamo, Goliad and San Jacinto. The first battle of the Texas Revolution at Gonzales is not so well known. But, I have an advantage over most people, I had 6$^{th}$ Grade Texas History and I remember Gonzales.

At Gonzales, the Mexican Colonel demanded that the Texans surrender their cannon. The Texans refused and buried it in a peach orchard. The Texans then displayed their flag with a drawing of the cannon and the motto “Come and Take It.” The Mexican Colonel was outnumbered so he retreated.

Both promoters and investors in potentially abusive tax shelters are hiding their identity and their transactions behind privilege to avoid and frustrate IRS examinations. They are challenging the IRS to come and take it. But unlike the Mexican Colonel at Gonzales, we are not going to retreat. Where appropriate, and pursuant to our statutory authority, we are going to come and take the identity of tax shelter investors and the other information to which we are entitled. We believe that the law and good tax administration require us to do so. We may not win every case, but we believe that the courts will sustain our authority to obtain the information that we need to administer the tax law, including the identity of investors in potentially abusive tax shelters.