Despite the Success Achieved, the Son of Boss Settlement Had Little Impact on Investor Filing and Payment Compliance

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FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

December 30, 2008

MEMORANDUM FOR COMMISSIONER, LARGE AND MID-SIZE BUSINESS DIVISION
COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

Nancy A. Nakamura

FROM: *(for)* Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Despite the Success Achieved, the Son of Boss Settlement Had Little Impact on Investor Filing and Payment Compliance (Audit # 200730IE041)

This report presents the results of our review of the impact that the Son of Boss (Bond and Option Sales Strategies)[1] settlement initiative had on investor filing and payment compliance. The overall objective of this review was to evaluate whether participants and non-participants in the Son of Boss settlement are meeting their Federal tax obligations. The review was conducted as part of our planned Fiscal Year 2008 audit coverage.

Impact on the Taxpayer

The ability of the Internal Revenue Service (IRS) to successfully administer the nation's tax system is heavily dependent upon the public's perception about its fairness. Many involved in tax administration, including Congress, the IRS, the Treasury Inspector General for Tax Administration, and the Government Accountability Office, believe that the Son of Boss and other abusive tax shelters can give the appearance that the tax system is unfair, which in turn can undermine voluntary compliance. The perception of fairness might be further aggravated when a tax shelter settlement, such as the Son of Boss settlement, allows taxpayers to deduct a portion of the costs associated with investing in the abusive tax shelter even when they fail to meet their tax return filing and payment obligations.

[1] Internal Revenue Service Notice 2000-44, Tax Avoidance Using Artificially High Basis, 2000-36 IRB 255, describes "Son of Boss" transactions as arrangements that are "designed to produce noneconomic tax losses on the disposition of partnership interests."

Synopsis

The IRS has a long history of using incentives as a tax administration tool to resolve controversy and foster compliance. The Son of Boss settlement was one such incentive that provided participating taxpayers and the IRS with the opportunity to save time and money that might otherwise have been spent on a protracted dispute over the Son of Boss abusive tax shelter. Investors participating in the settlement were allowed to deduct a portion of their transaction costs, typically promoter and professional fees, and, in some instances, avoid tens of thousands of dollars in penalties that could have been imposed.

The Offer in Compromise (OIC)[2] is another incentive that is, perhaps, more widely known to the public due to IRS outreach efforts and the considerable amount of advertising appearing in the media about taxpayers settling their tax liabilities for much less than the amounts actually owed. Although an OIC does allow an eligible taxpayer to settle his or her tax liability for less than the full amount owed, it also benefits the IRS. An OIC provides the IRS with an opportunity to collect revenue that might otherwise not be collectible and to receive a key compliance commitment from the taxpayer.

It is important to recognize that there are differences, as well as similarities, between the Son of Boss settlement and the OIC. One important difference is that the Son of Boss settlement was focused on promoting voluntary reporting compliance while the focus of an OIC is on promoting voluntary filing and payment compliance. However, both incentives ultimately resolve issues for less than the amounts that could have been owed and are promoted as being in the best interest of the Federal Government and the taxpaying public. Because of these similarities, we analyzed features in each incentive and have observations that the IRS might find useful in designing future tax shelter settlements. Specifically, our analysis suggests that incorporating greater transparency as well as filing and payment compliance commitments in tax shelter settlements might help alleviate any potential fairness concerns associated with abusive tax shelters.

In establishing the statutory procedures for an OIC, Congress recognized the potential fairness issues related to settling for less than the full amount owed by granting the IRS the authority under the Internal Revenue Code[3] to publicly disclose certain information about each OIC, including the name of the taxpayer, the amount of the debt compromised, and the amount accepted by the Federal Government as full payment of the liability. Although Congress did not extend this authority to tax shelter settlements, such transparency is important in terms of

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[2] An OIC is an agreement between the taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed. According to the IRS, it will generally accept an OIC when it is unlikely that the tax liability can be collected in full and the amount reasonably reflects collection potential. The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Federal Government.

[3] Internal Revenue Code Section 6103(k)(1) (2008).

fairness because it helps assure taxpayers that the tax law and related administrative procedures are applied consistently and are not favoring one taxpayer over another.

With respect to filing and payment compliance commitments, taxpayers who have their liabilities compromised face losing the benefits they receive under an OIC because the IRS can reinstate the debt and resume collection actions if they fail to meet all their filing and payment obligations in the succeeding 5 years. In contrast, taxpayers who participated in the Son of Boss settlement were not required to make a similar commitment as a condition for keeping the settlement's benefits. We believe that there are at least two reasons why linking future filing and payment compliance with the potential loss of benefits is important from a tax system fairness perspective. First, it ensures that there are consequences that extend beyond the delinquency penalties an otherwise compliant taxpayer in the general population might occasionally incur. Second, our work and that of the IRS suggest that the prospect of losing benefits contributes to a high level of voluntary filing and payment compliance.

Our evaluation of voluntary filing and payment compliance in the 3 years following the Son of Boss settlement showed that 300 (27 percent) of the 1,103 taxpayers who participated in the settlement did not meet their filing and payment obligations. Comparatively, we reported in 2004[4] that 96 percent of the 84 taxpayers evaluated in a statistical sample of 28,018 OICs were in compliance with their filing and payment obligations at the time of our review.

The seemingly high level of voluntary filing and payment compliance linked to the compliance commitments in the OIC is significant because enhancing voluntary compliance is key to reducing the annual tax gap.[5] The relationship between tax system fairness and tax gap reduction can, perhaps, be best summarized by the following comments from Senator Max Baucus that appeared in a July 16, 2008, Senate Finance Committee news release: "The sooner we can close the tax gap, the better. It's a matter of fairness to hard-working, law-abiding taxpayers who are forced to pick up a bigger burden because others don't pay what they owe."

Response

Although this report discusses compliance issues related to participants in the Son of Boss settlement, we are not recommending any specific corrective actions. Because our review focused only on the Son of Boss settlement, we have no basis for knowing whether the filing and payment compliance issues noted were unique to the participants in the Son of Boss settlement or are prevalent among participants in other tax shelter settlements. Therefore, we have no basis for recommending specific changes to IRS policies and procedures. However, IRS officials did

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[4] *Monitoring of Offers in Compromise Is Generally Effective, but Some Improvement Is Needed* (Reference Number 2004-30-043, dated January 2004).

[5] The tax gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.

have an opportunity to review and provide comments on a draft of this report. We incorporated the comments where appropriate.

Copies of this report are also being sent to IRS managers affected by the report issues. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

Table of Contents

Background .... Page 1

Results of Review .... Page 3

The Ability to Successfully Administer the Nation's Tax System Depends in Large Part on the Public's Perception About Its Fairness .... Page 3

Appendices

Appendix I – Detailed Objective, Scope, and Methodology .... Page 10

Appendix II – Major Contributors to This Report .... Page 12

Appendix III – Report Distribution List .... Page 13

Appendix IV – Investor Tax Return Information .... Page 14

Abbreviations

Boss	Bond and Option Sales Strategies
IRS	Internal Revenue Service
OIC	Offer in Compromise

Background

The taxpaying public has long sought ways to minimize tax liabilities by sheltering income and gains from taxes through use of investments and other financial-related transactions. Some tax shelters, however, have received widespread publicity because they purportedly abuse the tax law, represent a significant loss of tax revenue, and undermine the public's confidence in the tax system. The Son of Boss (Bond and Option Sales Strategies)[1] is one such abusive tax shelter. The Internal Revenue Service (IRS) determined that other than generating tax benefits, it lacked a business purpose and estimated that it understated tax liabilities by more than $6 billion.

The IRS characterized the Son of Boss abusive tax shelter as a highly sophisticated, technically complex, no-risk scheme designed to generate tax losses without corresponding economic risks that was promoted by some prominent firms in the financial services industry to investors seeking to shelter large gains from the sale of a business or capital asset. The scheme used flowthrough entities, such as partnerships, and various financial products[2] to add steps and complexity to transactions that had little or no relationship to the investor's business or the asset sale creating the sheltered gain.

In addition to adding to the complexity of the transactions, the losses generated from the Son of Boss tax shelter were often reported among other "legitimate" items in several parts of the income tax return. For example, some losses were reported as reductions to gross sales, cost of goods sold, or capital gains. Taken together, the characteristics of the transactions, especially the use of flowthrough entities, made it very difficult for the IRS to detect the Son of Boss abusive tax shelter through its traditional process of screening returns individually for questionable items.

Announced publicly on May 5, 2004,[3] the Son of Boss settlement allowed investors the opportunity to disclose their involvement in the Son of Boss abusive tax shelter in exchange for avoiding penalties and for offsetting some of the losses the IRS would disallow by the amount of out-of-pocket[4] expenses they had paid to the promoters. As a result, the IRS was able to quickly identify hundreds of investors and recoup billions of dollars in tax revenue.

This review was performed at the Treasury Inspector General for Tax Administration offices in Washington, D.C., and Los Angeles, California, during the period November 2007 through

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[1] Internal Revenue Service Notice 2000-44, Tax Avoidance Using Artificially High Basis, 2000-36 IRB 255, describes "Son of Boss" transactions as arrangements that are "designed to produce noneconomic tax losses on the disposition of partnership interests."
[2] The IRS defines financial products as instruments used in the global market place. They include, among others, stocks, bonds, foreign currencies, mortgages, commodities, and derivatives.
[3] IRS Announcement 2004-46.
[4] Out-of-pocket expenses are transaction fees the investors paid to promoters.

April 2008. We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

The IRS has a long history of using incentives as a tax administration tool to resolve controversy and foster compliance. The Son of Boss settlement was one such incentive that provided investors and the IRS with an opportunity to save time and money that might otherwise have been spent on a protracted dispute. Investors participating in the settlement were allowed to deduct a portion of the fees paid to promoters and, in some instances, avoided tens of thousands of dollars in penalties that could have been imposed in exchange for conceding most benefits.

The Offer in Compromise (OIC)[5] is another incentive that is, perhaps, more widely known to the public due to IRS outreach efforts and the considerable amount of advertising appearing in the media about taxpayers settling their tax liabilities for much less than the amounts actually owed. Although an OIC does allow an eligible taxpayer to settle his or her tax liability for less than the full amount owed, it also benefits the IRS. Among other things, an OIC provides the IRS with an opportunity to collect revenue that might otherwise not be collectible and to receive a key compliance commitment from the taxpayer.

The Ability to Successfully Administer the Nation's Tax System Depends in Large Part on the Public's Perception About Its Fairness

Many involved in tax administration, including Congress, the IRS, the Treasury Inspector General for Tax Administration, and the Government Accountability Office, believe that abusive tax shelters can give the appearance that the tax system is unfair, which in turn can undermine voluntary compliance. In addition to threatening voluntary compliance, abusive tax shelters pose a significant threat to tax revenues. The IRS estimated that the potential revenue loss to the Department of the Treasury from abusive tax shelters was in the tens of billions of dollars over a decade.

Given the seriousness of these abuses, it is not surprising that the IRS, the Department of Justice, and State tax authorities have focused considerable efforts and resources on identifying, monitoring, and prosecuting promoters and participants in abusive tax shelters. Besides these

[5] An OIC is an agreement between the taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed. According to the IRS, it will generally accept an OIC when it is unlikely that the tax liability can be collected in full and the amount reasonably reflects collection potential. The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Federal Government.

efforts, Congress has developed and enacted a significant amount of legislation to deal with the problem, as noted in the following press statement attributed to Senator Charles Grassley:[6]

> *. . . we were successful last fall in enacting the most comprehensive anti-tax shelter provisions since 1986. These provisions are meant to give the IRS more information to find abuses and crack down on them, ideally before they catch on with thousands of clients like Son of Boss did. I look forward to continuing to work with the IRS on anti-shelter.*

By most accounts, the Son of Boss settlement was very successful in addressing the issues associated with wealthy individuals using a tax shelter to understate taxes. Former IRS Commissioner Mark W. Everson noted that the settlement secured significant revenue, as highlighted in the following press statement:[7] "The $3.2 billion is cash that the IRS has in hand,' Everson said. Neither he nor other IRS officials would give names or discuss details of individual cases, but Everson did say that 'some people have had to sell their villas or yachts."

Despite the success achieved, the Son of Boss settlement had little impact on investor filing and payment compliance. Our evaluation of investor filing and payment compliance in the 3 years following the settlement showed that the settlement's participants were far less likely to meet their Federal tax obligations without IRS intervention than the general taxpayer population, even though their median[8] adjusted gross incomes[9] rose from $288,458 to $470,355.[10] In addition, our work comparing and analyzing features found in the Son of Boss settlement and an OIC suggests that incorporating greater transparency as well as filing and payment compliance commitments in tax shelter settlements might further help alleviate potential fairness concerns associated with abusive tax shelters.

The effect of the Son of Boss settlement on investor voluntary filing and payment compliance was not large

We analyzed the tax accounts of 1,825 individual taxpayers the IRS had identified as investors in the Son of Boss tax shelter to determine how well they met their Federal tax return filing and payment obligations in the 3 tax years following the settlement. We identified 534 investors (29 percent) who did not meet their Federal tax obligations with respect to filing tax returns on time and paying their taxes when due. As summarized in Figure 1, the 534 investors included 74 who had not filed 1 or more tax returns and 89 who filed tax returns late and were assessed $1.26 million in late filing penalties. In addition, another 371 investors failed to pay their taxes

[6] United States Senate Committee on Finance, Memorandum, March 24, 2005.
[7] Albert B. Crenshaw, "IRS Crackdown on Tax Shelter Nets $3.2 Billion," *The Washington Post*, March 25, 2005.
[8] The median divides amounts into halves; one-half of the amounts are above the median, and one-half are below it.
[9] Income after certain allowable adjustments from total income, such as Individual Retirement Arrangement contributions, alimony paid, and moving expenses.
[10] Additional investor tax return information for the 3 tax years following the Son of Boss settlement is presented in Appendix IV.

on time and were assessed late payment penalties. The delinquent taxes with interest and penalties totaled $28 million.

Figure 1: Analysis of Son of Boss Investor Filing and Payment Compliance for Tax Years 2004 - 2006

Total Son of Boss investors analyzed (1,825)	Number	Amount Owed
Investors who have not filed one or more tax returns	74	Unknown
Investors who were assessed delinquency penalties for filing tax returns late	89	$1.26 million
Investors who were assessed delinquency penalties for paying taxes late	371	$28 million
Investors who participated in the Son of Boss settlement (1,103)		
Investors who have not filed one or more tax returns	38	Unknown
Investors who were assessed delinquency penalties for filing tax returns late	43	$482,000
Investors who were assessed delinquency penalties for paying taxes late	219	$14.3 million
Investors who did not participate in the Son of Boss settlement (722)		
Investors who have not filed one or more tax returns	36	Unknown
Investors who were assessed delinquency penalties for filing tax returns late	46	$773,000
Investors who were assessed delinquency penalties for paying taxes late	152	$13.7 million

Source: Our analysis of the IRS Master File.[11]

When we compared the levels of Federal tax return filing and payment compliance for the 1,103 investors who participated in the settlement to those of the 722 non-participating investors, we found little difference between the 2 groups in terms of filing their returns on time and paying their taxes when due. As Figure 1 shows, 300 (27 percent) of the 1,103 participants and 234 (32 percent) of the 722 non-participants did not meet their filing and payment obligations and required or will require IRS intervention.

Moreover, the percentage of investors in both groups who are not meeting their filing and payment obligations is significantly higher than the noncompliance rate in the general taxpayer population. In August 2007, the Department of the Treasury and the IRS issued a report entitled *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance,* which indicated that the noncompliance rate overall is 16.3 percent.

[11] The Master File contains, among other things, postings of tax data and related information pertaining to taxpayers so that the File reflects a continuous updated and current record of each taxpayer's account.

Greater transparency and compliance commitments might help alleviate potential fairness concerns

Although tax shelter settlements are an important tax administration tool, the fact that they resolve issues for amounts less than what could have been owed might exacerbate the appearance of unfairness in our tax system that is associated with abusive tax shelters. The fairness issue might be further aggravated when a tax shelter settlement allows participating taxpayers to deduct a portion of the costs associated with investing in the abusive tax shelter even when they fail to meet their tax return filing and payment obligations.

We do not have any data to indicate the effect that tax shelter settlements are having on the attitudes of the vast majority of taxpayers who do not participate in abusive tax shelters and pay their taxes in full. However, in establishing the statutory procedures for an OIC, Congress recognized the potential fairness issues related to settling for less than the full amount owed by granting the IRS the authority under the Internal Revenue Code[12] to disclose certain information about each OIC. This includes the name of the taxpayer whose debt was compromised, the amount of the debt compromised, and the amount accepted by the Federal Government as full payment of the liability. Although this authority does not extend to tax shelter settlements, such transparency is important in terms of fairness because it helps assure taxpayers that the tax law and related administrative procedures are applied consistently and are not favoring one taxpayer over another.

Besides transparency, there are other differences, as well as similarities, between the Son of Boss settlement and an OIC, as outlined in Figure 2. One important difference is that the Son of Boss settlement was focused on promoting voluntary reporting compliance while the focus of an OIC is on promoting voluntary filing and payment compliance. One similarity is that both are incentives offered to noncompliant taxpayers because they either invested in an abusive tax shelter the IRS described as a no-risk scheme designed to generate tax losses or–in the case of an OIC–are asking to pay less than the IRS has determined is owed. Both incentives also ultimately settle debts for less than the amounts that could have been owed and are promoted as being in the best interest of the Federal Government and the taxpaying public. Because of the similarities between the two incentives, we analyzed features in each and have observations that the IRS might find useful in designing future tax shelter settlements. Specifically, our analysis suggests that besides greater transparency, incorporating filing and payment compliance commitments in tax shelter settlements might help alleviate any potential fairness concerns associated with abusive tax shelters.

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[12] Internal Revenue Code Section 6103(k)(1) (2008).

Figure 2: Selected Features Found in the Son of Boss Settlement and in an OIC

Selected Features	*OIC*	*Son of Boss Settlement*
Promoted as being in the best interest of the Federal Government and taxpayers	●	●
Settles issues for less than the amounts that could have been owed	●	●
Involves only noncompliant taxpayers by definition	●	●
Makes information about the settlement available for public inspection	●	○
Considered for liabilities that have yet to be assessed	○	●
Focused on promoting voluntary filing and payment compliance	●	○
Focused on promoting voluntary reporting compliance	○	●
Requires returns to be filed on time and taxes to be paid when due to keep benefits	●	○
Encourages the disclosure of participation in tax shelters	○	●
Requires estimated tax payments to be current	●	○
Yes ● No ○		

Source: Our analysis of Internal Revenue Manual 8.23.1, Offer in Compromise (Form 656), and IRS Announcement 2004-46.

With respect to filing and payment commitments, taxpayers who have their liabilities compromised face losing the benefits they receive under an OIC because the IRS can reinstate the debt and resume collection actions if they fail to meet all of their filing and payment obligations in the succeeding 5 years. In contrast, taxpayers who participated in the Son of Boss settlement were not required to make a similar commitment as a condition for deducting promoter and professional fees and, in some instances, avoiding the imposition of penalties. We believe that there are at least two reasons why linking future filing and payment compliance with the potential loss of benefits is important from a tax system fairness perspective. First, it ensures that there are consequences that extend beyond the delinquency penalties an otherwise compliant taxpayer in the general population might occasionally incur. Second, our work and that of the

IRS suggest that the prospect of losing benefits contributes to a high level of voluntary filing and payment compliance.

As we reported in 2004,[13] 96 percent of the 84 taxpayers evaluated in a statistical sample of 28,018 OICs were in compliance with their filing and payment obligations at the time of our review. In an earlier study covering Calendar Years 1995 through 2001, the IRS reported[14] finding that 80.1 percent of individual taxpayers who had their debts compromised were meeting their filing and payment obligations. While this percentage is lower than our findings in 2004, it is nevertheless notable considering that these were all previously noncompliant taxpayers.

The seemingly high level of voluntary filing and payment compliance linked to the compliance commitments in the OIC is significant because enhancing voluntary compliance is key to reducing the annual tax gap.[15] The relationship between tax system fairness and tax gap reduction can, perhaps, be best summarized by the following comments from Senator Max Baucus that appeared in a July 16, 2008, Senate Finance Committee news release: "The sooner we can close the tax gap, the better. It's a matter of fairness to hard-working, law-abiding taxpayers who are forced to pick up a bigger burden because others don't pay what they owe."

The IRS would face challenges to incorporating greater transparency and compliance commitments in future tax shelter settlements

Before the IRS makes any decision about including filing and payment commitments and allowing for greater transparency in future tax shelter settlements, it will need to consider at least three factors.

- The benefit that might be derived from obtaining a filing and payment commitment from taxpayers as a condition for participating in future tax shelter settlements would need to be weighed against the costs of providing it. Just as it does with an OIC, the IRS would incur costs associated with monitoring the filing and payment requirements of investors who participate in a tax shelter settlement. In addition, fewer investors might be willing to participate in a tax shelter settlement if they risk losing the benefits of the settlement for not meeting their future Federal tax obligations.
- The Internal Revenue Code would need to be changed to allow for the public disclosure of information about each settlement. As indicated earlier in the report, Internal Revenue Code Section 6103 specifically allows the IRS to disclose taxpayer information about an OIC. However, it generally prohibits the IRS from publicly disclosing other Federal tax

[13] *Monitoring of Offers in Compromise Is Generally Effective, but Some Improvement Is Needed* (Reference Number 2004-30-043, dated January 2004).

[14] IRS, *Accepted Offers In Compromise: Compliance With The Terms of the Offer.* Research Project 04.00.001.02, December 12, 2002.

[15] The tax gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.

information without taxpayer consent. Similar to the filing and payment commitment, the threat of disclosing information on each settlement might discourage taxpayers from participating in tax shelter settlements.

- Data would need to be collected as to whether current tax shelter settlements are, in fact, adversely affecting taxpayer perceptions about tax system fairness. Using such data as a measurement tool would be inherently difficult because each person's view of tax system fairness is largely subjective.

Although this report discusses filing and payment compliance issues related to participants in the Son of Boss settlement, we are not recommending any specific corrective actions. Because our review focused only on the Son of Boss settlement, we have no basis for knowing whether the filing and payment compliance issues were unique to participants in the Son of Boss settlement initiative or are prevalent among participants in other tax shelter settlements. Therefore, we have no basis for recommending specific changes to IRS policies and procedures.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate whether participants and non-participants in the Son of Boss[1] settlement are meeting their Federal tax obligations. During the review, we relied on information provided to us by the IRS. This information included Son of Boss investor databases and Master File[2] account data. Except as described below, we did not establish the reliability of these data due to the considerable amount of time and resources that would be needed to audit the data. We also did not assess internal controls because to do so would not have been applicable within the context of this audit. To accomplish our objective, we:

I. Reviewed a significant amount of source material to gain an understanding of the Son of Boss abusive tax shelter, an OIC,[3] and tax shelter settlements. These sources included reports issued by us and the Government Accountability Office; the Internal Revenue Code; the United States Treasury Regulations; and the IRS Internal Revenue Manual, publications, and training materials.

II. Assessed whether the information in the Son of Boss databases was reliable enough for our purposes by comparing key information in the databases to the IRS Master File accounts for Son of Boss abusive tax shelter investors.

III. Evaluated the levels of payment and reporting compliance among investors in the Son of Boss abusive tax shelter for Tax Years 2004 through 2006 by analyzing a Master File extract of individual investor accounts.

IV. Assessed how the various features of an OIC and the Son of Boss settlement addressed potential fairness issues that could be raised by the vast majority of taxpayers who voluntarily file their returns on time and pay their taxes when due.

V. Evaluated the IRS Return Transaction Files for Tax Years 2003 through 2005 to present a statistical portrayal of selected return items reported to the IRS by investors in the Son of

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[1] Internal Revenue Service Notice 2000-44, Tax Avoidance Using Artificially High Basis, 2000-36 IRB 255, describes "Son of Boss" transactions as arrangements that are "designed to produce noneconomic tax losses on the disposition of partnership interests."

[2] The Master File contains, among other things, postings of tax data and related information pertaining to taxpayers so that the File reflects a continuous updated and current record of each taxpayer's account.

[3] An OIC is an agreement between the taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed. According to the IRS, it will generally accept an OIC when it is unlikely that the tax liability can be collected in full and the amount reasonably reflects collection potential. The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Federal Government.

Boss abusive tax shelter. The Return Transaction File contains line item amounts that the IRS transcribed from the tax returns filed by taxpayers, including investors in the Son of Boss abusive tax shelter.

Appendix II

Major Contributors to This Report

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Appendix III

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Appendix IV

Investor Tax Return Information

Figure 1 presents selected line items from Son of Boss abusive tax shelter investor tax returns as filed with the IRS. It also shows that the median[1] adjusted gross income[2] and taxable income increased in each of the 2 tax years following the Son of Boss settlement. The settlement was publicly announced on May 5, 2004, which was shortly after the April 15, 2004, due date for Tax Year 2003 returns.

Figure 1: Selected Items From the Tax Returns Filed by Son of Boss Investors for Tax Years 2003 - 2005

Selected Tax Return Items	2003	2004	2005
Salaries and Wages			
Median	$150,000	$154,200	$148,844
Number of Returns	1,159	1,123	1,115
Interest Income			
Median	$29,985	$26,055	$35,668
Number of Returns	1,730	1,721	1,696
Itemized Deductions			
Median	$108,779	$136,443	$142,641
Number of Returns	1,679	1,672	1,635
Adjusted Gross Income			
Median	$288,458	$380,668	$470,355
Number of Returns	1,771	1,764	1,719
Taxable Income			
Median	$150,640	$185,507	$275,255
Number of Returns	1,771	1,764	1,719

Source: Our analysis of the IRS Return Transaction File. This File contains line item amounts that the IRS transcribed from the tax returns filed by taxpayers.

[1] The median divides amounts into halves; one-half of the amounts are above the median, and one-half are below it.
[2] Income after certain allowable adjustments to total income, such as Individual Retirement Arrangement contributions, alimony paid, moving expenses, and Keogh account contributions.