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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

[TD 8961]

RIN 1545-BA04

Modification of Tax Shelter Rules II

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: These temporary regulations modify the rules relating to the requirement that certain corporate taxpayers file a statement with their Federal corporate income tax returns under section 6011(a) and the registration of confidential corporate tax shelters under section 6111(d). These regulations provide the public with additional guidance needed to comply with the disclosure rules under section 6011(a), the registration requirement under section 6111(d), and the list maintenance requirement under section 6112 applicable to tax shelters. The temporary regulations affect corporations participating in certain reportable transactions, persons responsible for registering confidential corporate tax shelters, and organizers of potentially abusive tax shelters. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: Effective Date: These temporary regulations are effective August 2, 2001.

Applicability Date: For dates of applicability, see §1.6011-4T(g) and §301.6111-2T(h).

FOR FURTHER INFORMATION CONTACT: Danielle M. Grimm (202) 622-3080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### **Background**

This document amends 26 CFR parts 1 and 301 to provide modified rules relating to the disclosure of certain reportable transactions by corporate investors on their Federal corporate income tax returns under section 6011 and the registration of confidential corporate tax shelters under section 6111.

On February 28, 2000, the IRS issued temporary and proposed regulations regarding section 6011 (TD 8877, REG-103735-00), section 6111 (TD 8876, REG-110311-98), and section 6112 (TD 8875, REG-103736-00) (collectively, the February regulations). The February regulations were published in the **Federal Register** (65 FR 11205, 65 FR 11215, 65 FR 11211) on March 2, 2000. On August 11, 2000, the IRS issued temporary and proposed regulations regarding sections 6011, 6111, and 6112 (TD 8896, REG-103735-00, REG-110311-98, REG-103736-00) (collectively, the August regulations). The August regulations were published in the **Federal Register** (65 FR 49909) on August 16, 2000, modifying the February regulations.

Based on comments that have been received, the IRS and Treasury have determined that certain additional interim changes to the temporary and proposed regulations are warranted. The

changes in the proposed rules are published elsewhere in this issue of the **Federal Register**.

These interim changes are intended to assist taxpayers and ease tax administration by simplifying and clarifying certain provisions of the regulations, addressing certain practical problems relating to compliance with the regulations, and making certain other changes relating to the scope of the regulations. The IRS and Treasury continue to evaluate all the comments and recommendations received, and other changes may be made in the final regulations.

#### **Explanation of Provisions**

##### 1. Different Foreign Tax Treatment Characteristic in §1.6011-4T(b)(3)(i)(F)

Under section 6011, reportable transactions include listed transactions and transactions that have at least two of six specified characteristics. One of the characteristics is present if the expected characterization of any significant aspect of the transaction for Federal income tax purposes differs from the expected characterization of such aspect of the transaction for purposes of taxation of any party to the transaction in another country. Commentators have suggested that the inclusion of this characteristic causes the regulations to be overinclusive. Based on these comments and further review, the IRS and Treasury have removed this characteristic from the temporary and proposed regulations.

##### 2. Clarification of Exceptions Under §1.6011-4T

a. "Long-standing and generally accepted exception" in §1.6011-4T(b)(3)(ii)(B)

The temporary regulations under section 6011 provide that a transaction, other than a listed transaction, is not a reportable transaction if one of four exceptions is satisfied. One exception applies if the taxpayer has participated in the transaction in the ordinary course of its business in a form consistent with customary commercial practice, and the taxpayer reasonably determines that there is a long-standing and generally accepted understanding that the expected Federal income tax benefits (taking into account any combination of intended tax consequences) from the transaction are allowable under the Code for substantially similar transactions.

Commentators have requested additional guidance on the meaning of the phrase "long-standing and generally accepted" that is contained in this exception. This exception is intended to apply to transactions the structure of which is customary and the intended tax treatment of which is widely known and generally accepted as properly allowable under the Internal Revenue Code. Ordinarily, a determination as to whether the intended tax treatment of a transaction has achieved such a level of general acceptance cannot be made unless information relating to the structure and tax treatment of substantially similar transactions has been in the public domain and widely known for a period of years. However, the applicability of this exception does not depend on such general acceptance having existed for any minimum period of time. Accordingly, the IRS and Treasury have

eliminated the phrase "long-standing" from the exception and have added language to clarify the scope of the exception.

Corresponding changes have been made in §301.6111-2T.

b. "No reasonable basis exception" in §1.6011-4T(b)(3)(ii)(C)

This exception generally provides that a transaction, other than a listed transaction, is not reportable if the taxpayer reasonably determines that there is no reasonable basis under Federal tax law for denial of any significant portion of the expected Federal income tax benefits from the transaction. Commentators have requested additional guidance on the no reasonable basis determination. Accordingly, the regulations clarify that for purposes of this exception, whether the IRS would have a reasonable basis for its position is to be determined by applying the same standard as that applicable to taxpayers under §1.6662-3(b)(3). Thus, the reasonable basis standard is not satisfied by an IRS position that would be merely arguable or that would constitute merely a colorable claim. The determination of whether the IRS would have such a reasonable basis is qualitative in nature and does not depend on any percentage or other quantitative assessment of the likelihood that the taxpayer would ultimately prevail if a significant portion of the expected tax benefits were disallowed by the IRS. Corresponding changes have been made to newly redesignated §301.6111-2T(b)(4)(i).

3. Economic Substance Test

Commentators have suggested that the economic substance

test, as articulated in §301.6111-2T(b)(3), may encompass transactions for which registration pursuant to section 6111(d) or list maintenance under section 6112 would not be appropriate. Further, the IRS and Treasury believe that substantially all transactions encompassed by the economic substance test for which registration and list maintenance are appropriate will constitute other tax structured transactions within the meaning of §301.6111-2T(b)(4). Accordingly, the economic substance test as described in §301.6111-2T(b)(3) is removed from the temporary and proposed regulations under section 6111.

4. Presumption Against Confidentiality

Section 301.6111-2T(c)(3) contains a presumption that, unless facts and circumstances clearly indicate otherwise, an offer is not considered made under conditions of confidentiality if the tax shelter promoter provides express written authorization to each offeree permitting the offeree (and each employee, representative, or other agent of such offeree) to disclose the structure and tax aspects of the transaction to any and all persons, without limitation of any kind on such disclosure. There has been a request to clarify the phrase "to disclose the structure and tax aspects of the transaction." Accordingly, the IRS and Treasury have added language to clarify that this phrase is to be construed broadly and includes all materials (including opinions or other tax analyses) that are provided to the offeree related to the structure and tax aspects of the transaction.

5. Tax Shelter Registration in §301.6111-2T(e)(2)(ii)(E)

The August regulations provided that the Form 8264, "Application for Registration of a Tax Shelter," was to be filed with the Kansas City Service Center. Recently, the Service issued Announcement 2001-62 (2001-24 I.R.B. 1337), instructing taxpayers to file these forms with the Ogden Service Center. The instructions to Form 8264 will be revised to reflect the change in filing location. Accordingly, the regulations are amended to provide that the Form 8264 is to be filed as prescribed in the instructions to the form.

6. Effective Date

The regulations are applicable August 2, 2001. However, in general, taxpayers may rely on the regulations after February 28, 2000.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations impose no new collection of information on small entities, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business

Administration for comment on their impact on small business.

### **Drafting Information**

The principal author of these regulations is Danielle M. Grimm, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects**

#### 26 CFR Part 1

Income taxes, Reporting and record keeping requirements.

#### 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and record keeping requirements.

### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

#### PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.6011-4T is amended as follows:

1. Paragraph (b)(3)(i)(F) is removed.
2. Paragraphs (b)(3)(ii)(B) and (C) are revised.
3. Paragraph (b)(5) is amended by removing the language "long-standing and" from the fifth sentence in Example 1 and the seventh sentence in Example 3.
4. Paragraph (g) is revised.



The revisions and addition read as follows:

§1.6011-4T Requirement of statement disclosing participation in certain transactions by corporate taxpayers (Temporary).

\* \* \* \* \*

(b) \* \* \*

(3) \* \* \*

(ii) \* \* \*

(B) The taxpayer has participated in the transaction in the ordinary course of its business in a form consistent with customary commercial practice, and the taxpayer reasonably determines that there is a generally accepted understanding that the taxpayer's intended tax treatment of the transaction (taking into account any combination of intended tax consequences) is properly allowable under the Internal Revenue Code for substantially similar transactions. There is no minimum period of time for which such a generally accepted understanding must exist. In general, however, a taxpayer cannot reasonably determine whether the intended tax treatment of a transaction has become generally accepted unless information relating to the structure and tax treatment of such transactions has been in the public domain (e.g., rulings, published articles, etc.) and widely known for a sufficient period of time (ordinarily a period of years) to provide knowledgeable tax practitioners and the IRS reasonable opportunity to evaluate the intended tax treatment. The mere fact that the taxpayer may have received an opinion or advice from one or more knowledgeable tax practitioners to the

effect that the taxpayer's intended tax treatment of the transaction should or will be sustained, if challenged by the IRS, is not sufficient to satisfy the requirements of this paragraph (b)(3)(ii)(B).

(C) The taxpayer reasonably determines that there is no reasonable basis under Federal tax law for denial of any significant portion of the expected Federal income tax benefits from the transaction. This paragraph (b)(3)(ii)(C) applies only if the taxpayer reasonably determines that there is no basis that would meet the standard applicable to taxpayers under §1.6662-3(b)(3) under which the IRS could disallow any significant portion of the expected Federal income tax benefits of the transaction. Thus, the reasonable basis standard is not satisfied by an IRS position that would be merely arguable or that would constitute merely a colorable claim. However, the taxpayer's determination of whether the IRS would or would not have a reasonable basis for such a position must take into account the entirety of the transaction and any combination of tax consequences that are expected to result from any component steps of the transaction, must not be based on any unreasonable or unrealistic factual assumptions, and must take into account all relevant aspects of Federal tax law, including the statute and legislative history, treaties, administrative guidance, and judicial decisions that establish principles of general

application in the tax law (e.g., Gregory v. Helvering, 293 U.S. 465 (1935)). The determination of whether the IRS would or would not have such a reasonable basis is qualitative in nature and does not depend on any percentage or other quantitative assessment of the likelihood that the taxpayer would ultimately prevail if a significant portion of the expected tax benefits were disallowed by the IRS.

\* \* \* \* \*

(g) Effective date. This section applies to Federal corporate income tax returns filed after February 28, 2000. However, paragraphs (b)(3)(ii)(B), (b)(3)(ii)(C), and (b)(5) Examples 1 and 3, of this section apply to Federal corporate income tax returns filed after August 2, 2001. Taxpayers may rely on the rules in paragraphs (b)(3)(ii)(B), (b)(3)(ii)(C), and (b)(5) Examples 1 and 3, of this section for Federal corporate income tax returns filed after February 28, 2000. Otherwise, the rules that apply with respect to Federal corporate income tax returns filed after February 28, 2000, and on or before August 2, 2001, are contained in §1.6011-4T in effect prior to August 2, 2001 (see 26 CFR part 1 revised as of April 1, 2001).

PART 301--PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 4. Section 301.6111-2T is amended as follows:

1. Paragraph (b)(1) is revised.
2. Paragraph (b)(3) is removed.
3. Paragraphs (b)(4), (b)(5), (b)(6) and (b)(7) are redesignated paragraphs (b)(3), (b)(4), (b)(5) and (b)(6), respectively.
4. Newly redesignated paragraph (b)(3) introductory text is amended by revising the reference to "(b)(4)" with "(b)(3)."
5. Newly redesignated paragraph (b)(3)(ii) is revised.
6. Newly redesignated paragraph (b)(4) introductory text is amended by removing the reference "(b)(5)(i)" and adding "(b)(4)(i)" in its place.
7. Newly redesignated paragraph (b)(4)(i) is revised.
8. Newly redesignated paragraph (b)(4)(ii) is amended by removing the reference "(b)(6)" and adding "(b)(5)" in its place.
9. Newly redesignated paragraph (b)(6) is amended as follows:
  - a. Paragraph (b)(6), introductory text, is revised.
  - b. Example 1 is removed.
  - c. "Example 2." is redesignated as "Example."
  - d. The language "long-standing and" is removed from paragraph (i) in the newly redesignated Example.
  - e. The fourth sentence of paragraph (i) in the newly redesignated Example is removed.
  - f. Paragraph (ii) in the newly redesignated "Example" is

revised.

10. Paragraphs (c)(3) and (e)(2)(ii)(E) are revised.

11. Paragraph (h) is amended by adding 3 sentences at the end.

The revisions and additions read as follows:

§301.6111-2T Confidential corporate tax shelters (temporary).

\* \* \* \* \*

(b) \* \* \* (1) In general. The avoidance or evasion of Federal income tax will be considered a significant purpose of the structure of a transaction if the transaction is described in paragraph (b)(2) or (3) of this section. However, a transaction described in paragraph (b)(3) of this section need not be registered if the transaction is described in paragraph (b)(4) of this section. For purposes of this section, Federal income tax benefits include deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, and any other tax consequences that may reduce a taxpayer's Federal income tax liability by affecting the timing, character, or source of any item of income, gain, deduction, loss, or credit.

\* \* \* \* \*

(3) \* \* \*

(ii) There is a generally accepted understanding that the expected Federal income tax benefits from the transaction (taking into account any combination of intended tax consequences) are

properly allowable under the Internal Revenue Code for substantially similar transactions. There is no minimum period of time for which such a generally accepted understanding must exist. In general, however, a tax shelter promoter (or other person who would be responsible for registration under this section) cannot reasonably determine whether the intended tax treatment of a transaction has become generally accepted unless information relating to the structure and tax treatment of such transactions has been in the public domain (e.g., rulings, published articles, etc.) and widely known for a sufficient period of time (ordinarily a period of years) to provide knowledgeable tax practitioners and the IRS reasonable opportunity to evaluate the intended tax treatment. The mere fact that one or more knowledgeable tax practitioners have provided an opinion or advice to the effect that the intended tax treatment of the transaction should or will be sustained, if challenged by the IRS, is not sufficient to satisfy the requirements of this paragraph (b)(3)(ii).

(4) \* \* \*

(i) In the case of a transaction other than a transaction described in paragraph (b)(2) of this section, the tax shelter promoter (or other person who would be responsible for registration under this section) reasonably determines that there is no reasonable basis under Federal tax law for denial of any significant portion of the expected Federal income tax benefits

from the transaction. This paragraph (b)(4)(i) applies only if the tax shelter promoter (or other person who would be responsible for registration under this section) reasonably determines that there is no basis that would meet the standard applicable to taxpayers under §1.6662-3(b)(3) of this chapter under which the IRS could disallow any significant portion of the expected Federal income tax benefits of the transaction. Thus, the reasonable basis standard is not satisfied by an IRS position that would be merely arguable or that would constitute merely a colorable claim. However, the determination of whether the IRS would or would not have a reasonable basis for such a position must take into account the entirety of the transaction and any combination of tax consequences that are expected to result from any component steps of the transaction, must not be based on any unreasonable or unrealistic factual assumptions, and must take into account all relevant aspects of Federal tax law, including the statute and legislative history, treaties, administrative guidance, and judicial decisions that establish principles of general application in the tax law (e.g., Gregory v. Helvering, 293 U.S. 465 (1935)). The determination of whether the IRS would or would not have such a reasonable basis is qualitative in nature and does not depend on any percentage or other quantitative assessment of the likelihood that the taxpayer would ultimately prevail if a significant portion of the expected tax

benefits were disallowed by the IRS.

\* \* \* \* \*

(6) Example. The following example illustrates the application of paragraphs (b)(1) through (4) of this section. Assume, for purposes of the example, that the transaction is not the same as or substantially similar to any of the types of transactions that the IRS has identified as listed transactions under section 6111 and, thus, is not described in paragraph (b)(2) of this section. The example is as follows:

Example. \* \* \*

(ii) Analysis. The transaction represented by this combination of financial instruments is a transaction described in paragraph (b)(3) of this section. However, if Y is uncertain whether this transaction is described in paragraph (b)(3) of this section, or is otherwise uncertain whether registration is required, Y may apply for a ruling under paragraph (b)(5) of this section, and the transaction will not be required to be registered while the ruling is pending or for sixty days thereafter.

(c) \* \* \*

(3) Presumption. Unless facts and circumstances clearly indicate otherwise, an offer is not considered made under conditions of confidentiality if the tax shelter promoter provides express written authorization to each offeree permitting the offeree (and each employee, representative, or other agent of



such offeree) to disclose to any and all persons, without limitation of any kind, the structure and tax aspects of the transaction, and all materials of any kind (including opinions or other tax analyses) that are provided to the offeree related to such structure and tax aspects.

\* \* \* \* \*

(e) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(E) Sign the Form 8264 and file the form as prescribed in the instructions to the form.

\* \* \* \* \*

(h) Effective date. \* \* \* However, paragraphs (b)(1), (b)(3)(ii), (b)(4)(i), (b)(6)Example(i) and (ii), (c)(3), and (e)(2)(ii)(E) of this section apply to confidential corporate tax shelters in which any interests are offered for sale after August 2, 2001. The rules in paragraphs (b)(1), (b)(3)(ii), (b)(4)(i), (b)(6), (b)(6)Example(i) and (ii), (c)(3), and (e)(2)(ii)(E), of this section may be relied upon for confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000. Otherwise, the rules that apply to confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000, and on or before August 2, 2001 are contained in this §301.6111-2T in effect prior to August 2, 2001 (See 26 CFR part 301 revised as of April 1, 2001).

Par. 5. Section 301.6112-1T is amended by removing the authority citation immediately following the section.

David A. Mader

Acting Deputy Commissioner of Internal Revenue.

Approved: July 31, 2001

Mark Weinberger

Assistant Secretary of the Treasury.