

## Part III – Administrative, Procedural, and Miscellaneous

### Excise Taxes With Respect To Prohibited Tax Shelter Transactions to Which Tax-Exempt Entities Are Parties and Related Disclosure Requirements

#### Notice 2006-65

The Tax Increase Prevention and Reconciliation Act of 2005 (“TIPRA”), enacted on May 17, 2006, includes new excise taxes and disclosure rules that target certain potentially abusive tax shelter transactions to which a tax-exempt entity is a party. TIPRA creates a new § 4965 and amends §§ 6033(a)(2), 6011(g) and 6652(c)(3) of the Internal Revenue Code (“Code”). The amendments made by TIPRA were generally effective upon enactment and have broad application to tax-exempt entities and their managers.

Entities that may be affected by the new provisions include, but are not limited to, charities, churches, state and local governments, Indian tribal governments, qualified pension plans, individual retirement accounts, and similar tax-favored savings arrangements. The managers of these entities, and in some cases the entities themselves, can be subject to excise taxes if the entity is a party to a prohibited tax shelter transaction. Prohibited tax shelter transactions include transactions that are identified by the Internal Revenue Service (“IRS”) as potentially abusive “listed” tax avoidance transactions and reportable transactions that are confidential transactions or transactions with contractual protection. The newly enacted provisions also (1) contain new disclosure requirements, which apply not only to tax-exempt entities but also to taxable entities that are parties to prohibited tax shelter transactions involving tax-exempt entities, and (2) impose penalties for the failure to comply with the new disclosure requirements. A detailed description of the new TIPRA provisions is attached as an appendix.

The IRS and the Treasury Department (“Treasury”) are publishing this notice in order to ensure that affected entities are aware of the new TIPRA provisions, so that such entities can take the new taxes and disclosure obligations into account immediately. In addition, the IRS and Treasury are requesting public comments on the new provisions in anticipation of the publication of additional guidance. The IRS and Treasury are also interested in hearing from tax-exempt entities, practitioners and others potentially affected by the TIPRA provisions who would like the opportunity to discuss their questions, concerns and suggestions.

#### Request for Comments

The IRS anticipates including projects related to these TIPRA provisions in the annual Guidance Priority Plan that the IRS and Treasury expect to release soon. The IRS expects to issue guidance under these provisions promptly, and invites comments from the public regarding all aspects of the new excise taxes and disclosure requirements created by these provisions. Written comments should be submitted by August 11, 2006. Send submissions to: CC:PA:LPD:PR (Notice 2006-65), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (Notice 2006-65), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically to [notice.comments@irs.counsel.treas.gov](mailto:notice.comments@irs.counsel.treas.gov) (Notice 2006-65).

#### Drafting Information

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#### Appendix

##### *I. Overview of New § 4965, as Added by Section 516 of TIPRA*

Q-1: What excise taxes are imposed under new § 4965 of the Code, as added by section 516 of TIPRA?

A-1: Section 4965 imposes two new excise taxes. First, § 4965(a)(1) imposes an excise tax on certain tax-exempt entities that are parties to "prohibited tax shelter transactions," as defined in § 4965(e). See Part II of this appendix for the discussion of the entity-level excise tax under § 4965(a)(1). Second, § 4965(a)(2) imposes an excise tax on "entity managers" of tax-exempt entities who approve the entity as a party (or otherwise cause the entity to be a party) to a prohibited tax shelter transaction and know or have reason to know that the transaction is a prohibited tax shelter transaction. See Part III of this appendix for the discussion of the manager-level excise tax under § 4965(a)(2).

Q-2: What is a "tax-exempt entity"?

A-2: Under § 4965(c), the term "tax-exempt entity" refers to:

I. Non-Plan Entities, which are:

1. entities described in § 501(c), including but not limited to the following common types of entities:
  - a. instrumentalities of the United States described in § 501(c)(1);
  - b. churches, hospitals, museums, schools, scientific research organizations and other charities described in § 501(c)(3);
  - c. civic leagues, social welfare organizations and local associations of employees described in § 501(c)(4);
  - d. labor, agricultural or horticultural organizations described in § 501(c)(5);
  - e. business leagues, chambers of commerce, trade associations and other organizations described in § 501(c)(6);
  - f. voluntary employees' beneficiary associations (VEBAs) described in § 501(c)(9);
  - g. credit unions described in § 501(c)(14);
  - h. insurance companies described in § 501(c)(15); and
  - i. veterans' organizations described in § 501(c)(19);
2. religious or apostolic associations or corporations described in § 501(d);
3. entities described in § 170(c), including states, possessions of the United States, the District of Columbia, political subdivisions of states and political subdivisions of possessions of the United States (but not including the United States); and
4. Indian tribal governments within the meaning of § 7701(a)(40).

II. Plan Entities, which are:

5. qualified pension, profit-sharing and stock bonus plans described in § 401(a);
6. annuity plans described in § 403(a);
7. annuity contracts described in § 403(b);
8. qualified tuition programs described in § 529;
9. retirement plans described in § 457(b) maintained by a governmental employer;
10. individual retirement accounts within the meaning of § 408(a);
11. Archer Medical Savings Accounts ("MSAs") within the meaning of § 220(d);

12. individual retirement annuities within the meaning of § 408(b);
13. Coverdell education savings accounts described in § 530; and
14. health savings accounts within the meaning of § 223(d).

Q-3: Who is an “entity manager” for purposes of § 4965?

A-3: Under § 4965(d), the term “entity manager” means:

1. In the case of Non-Plan Entities (see Q&A-2), the term “entity manager” means the person with authority or responsibility similar to that exercised by an officer, director or trustee, and, with respect to any act, the person having authority or responsibility with respect to such act.
2. In the case of Plan Entities (see Q&A-2), the term “entity manager” means the person who approves or otherwise causes the entity to be a party to the prohibited tax shelter transaction. An individual beneficiary (including a plan participant) or owner of the tax-favored retirement plans, individual retirement arrangements, and savings arrangements described in § 401(a), 403(a), 403(b), 529, 457(b), 408(a), 220(d), 408(b), 530 or 223(d), may be liable as an entity manager if the individual beneficiary or owner has broad investment authority under the arrangement.

Q-4: What is a “prohibited tax shelter transaction”?

A-4: Under § 4965(e), the term “prohibited tax shelter transaction” means:

1. Listed transactions within the meaning of § 6707A(c)(2), which are transactions that are the same as, or substantially similar to, any transaction that has been specifically identified by the Secretary as a tax avoidance transaction for purposes of § 6011; and
2. Prohibited reportable transactions, which are:
  - a. Confidential transactions within the meaning of § 1.6011-4(b)(3) of the Income Tax Regulations; and
  - b. Transactions with contractual protection within the meaning of § 1.6011-4(b)(4) of the Income Tax Regulations.

## *II. Excise Tax on Certain Tax-Exempt Entities Under § 4965(a)(1)*

Q-5: Are all tax-exempt entities identified in Q&A-2 subject to the entity-level excise tax under § 4965(a)(1)?

A-5: No. Only the Non-Plan Entities identified in Q&A-2 are subject to the entity-level excise tax under § 4965(a)(1).

Q-6: What circumstances give rise to the entity-level excise tax under § 4965(a)(1)?

A-6: Under § 4965(a)(1), an entity-level excise tax is imposed on any Non-Plan Entity identified in Q&A-2 that becomes a party to a prohibited tax shelter transaction or is a party to a “subsequently listed transaction,” as defined in § 4965.

Q-7: For purposes of § 4965(a)(1), what is a “subsequently listed transaction”?

A-7: A “subsequently listed transaction” is a transaction that is identified as a listed transaction after the tax-exempt entity has become a party to the transaction and that was not a prohibited reportable transaction at the time the tax-exempt entity became a party to the transaction (§ 4965(e)(2)).

Q-8: What is the entity-level excise tax imposed under § 4965(a)(1) on a Non-Plan Entity identified in Q&A-2 that becomes a party to a prohibited tax shelter transaction (other than a subsequently listed transaction)?

A-8: The excise tax imposed under § 4965(a)(1) applies for the taxable year in which the entity becomes a party to the prohibited tax shelter transaction and any subsequent taxable year. The amount of tax depends on whether the tax-exempt entity knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity became a party to the transaction. If the tax-exempt entity did not know (and did not have reason to know) that the transaction was a prohibited tax shelter transaction at the time the entity became a party to the transaction, the tax is the highest rate of tax under § 11 (currently 35 percent) multiplied by the greater of: (i) the entity’s net income with respect to the prohibited tax shelter transaction (after taking into account any other applicable taxes with respect to such transaction) for the taxable year or (ii) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction (§ 4965(b)(1)(A)). If the tax-exempt entity knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity became a party to the transaction, the tax is the greater of (i) 100 percent of the entity’s net income with respect to the transaction (after taking into account any other applicable taxes with respect to such transaction) for the taxable year or (ii) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction (§ 4965(b)(1)(B)).

Q-9: What is the entity-level excise tax imposed under § 4965(a)(1) on a Non-Plan Entity identified in Q&A-2 that is a party to a subsequently listed transaction?

A-9: In the case of a subsequently listed transaction, the tax-exempt entity's income and proceeds attributable to the transaction are allocated between the periods before and after the listing and the tax for each taxable year is the highest rate of tax under § 11 (currently 35 percent) multiplied by the greater of (i) the entity's net income with respect to the subsequently listed transaction for the taxable year that is allocable to the period beginning on the later of the date such transaction is listed or the first day of the taxable year; or (ii) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction and allocable to the period beginning on the later of the date such transaction is listed or the first day of the taxable year (§ 4965(b)(1)(A)(i)(II) and (b)(1)(A)(ii)(II)).

### *III. Excise Tax on Entity Managers under § 4965(a)(2)*

Q-10: In what circumstances will an entity manager be subject to the manager-level excise tax under § 4965(a)(2)?

A-10: The manager-level excise tax under § 4965(a)(2) is imposed on any entity manager of a tax-exempt entity identified in Q&A-2 (whether it is a Plan Entity or a Non-Plan Entity) who approves the entity as a party (or otherwise causes such entity to be a party) to a prohibited tax shelter transaction and knows or has reason to know that the transaction is a prohibited tax shelter transaction.

Q-11: What is the manager-level excise tax imposed under § 4965(a)(2)?

A-11: The amount of tax is \$20,000 for each approval or other act causing the entity to be a party to the prohibited tax shelter transaction (§ 4965(b)(2)).

### *IV. Coordination Among Applicable Excise Taxes*

Q-12: Can the entity-level tax under § 4965(a)(1) and the manager-level tax under § 4965(a)(2) both apply with respect to the same prohibited tax shelter transaction?

A-12: Yes. In the case of a Non-Plan Entity identified in Q&A-2 that is a party to a prohibited tax shelter transaction, both the entity-level tax under § 4965(a)(1) and the manager-level tax under § 4965(a)(2) may apply. In the case of a Plan Entity that is a party to a prohibited tax shelter transaction, only the manager-level tax under § 4965(a)(2) may apply.

Q-13: What is the relationship between the excise taxes imposed by § 4965 and taxes and penalties otherwise imposed under the Code?

A-13: The excise taxes imposed by § 4965 are in addition to any other tax, addition to tax, or penalty imposed under the Code.

V. *New Disclosure Requirements Added by Section 516 of TIPRA*

Q-14: What new disclosure requirements are added by section 516 of TIPRA for a tax-exempt entity that is a party to a prohibited tax shelter transaction?

A-14: Section 516(b) of TIPRA amends § 6033 to require every tax-exempt entity identified in Q&A-2 (whether it is a Plan Entity or a Non-Plan Entity) that is a party to a prohibited tax shelter transaction to disclose to the Service (in such form and manner and at such time as determined by the Secretary) the following information: (a) that such entity is a party to the prohibited tax shelter transaction; and (b) the identity of any other party to the transaction which is known to such tax-exempt entity (§ 6033(a)(2), as amended by section 516(b) of TIPRA).

Q-15: What are the consequences of a failure by a tax-exempt entity to comply with the new disclosure requirements added by section 516 of TIPRA?

A-15: Section 516(c) of TIPRA amends § 6652(c) to impose a penalty for each failure by a tax-exempt entity identified in Q&A-2 to file a disclosure required under the amended § 6033(a)(2) with respect to such entity's involvement in any prohibited tax shelter transaction. Under the amended § 6652(c)(3)(A), the amount of the penalty is \$100 for each day during which such failure continues, not to exceed \$50,000 with respect to any one disclosure. Section 6652(c) is also amended to authorize the Secretary to make a written demand on any entity or manager subject to the penalty for nondisclosure under the amended § 6033(a)(2), specifying a reasonable future date by which the required disclosure must be filed (§ 6652(c)(3)(B)(i), as amended by section 516(c) of TIPRA). Failure to comply with the Secretary's demand is subject to an additional penalty in the amount of \$100 for each day after the expiration of the time specified in the demand during which such failure continues, not to exceed \$10,000 with respect to any one disclosure (§ 6652(c)(3)(B)(ii)).

Q-16: Who is liable for the penalties under the amended § 6652(c) for failure to file a disclosure and for failure to comply with the Secretary's demand for disclosure?

A-16: In the case of the Non-Plan Entities identified in Q&A-2, the penalty is imposed on the tax-exempt entity. In the case of the Plan Entities identified in Q&A-2, the penalty is imposed on the entity manager of the tax-exempt entity.

Q-17: What new disclosure requirements are added by section 516 of TIPRA for a taxable party to a prohibited tax shelter transaction?

A-17: Section 516(b) of TIPRA amends § 6011 to require any taxable party to a prohibited tax shelter transaction to disclose by statement to any tax-exempt entity identified in Q&A-2 which is a party to such transaction that such

transaction is a prohibited tax shelter transaction (§ 6011(g), as amended by section 516(b) of TIPRA).

Q-18: Are there any consequences for a failure by a taxable party to comply with the new disclosure requirements added by section 516 of TIPRA?

A-18: Yes. Taxable parties that fail to disclose to tax-exempt parties the information required by the amended § 6011(g) are subject to current law penalties for failure to comply with the various disclosure requirements imposed by § 6011. See § 6707A of the Code.

#### *VI. Effective Date for Excise Taxes*

Q-19: What is the effective date for the excise taxes imposed by new § 4965?

A-19: The excise taxes under § 4965 apply to taxable years ending after May 17, 2006, with respect to transactions entered into before, on, or after such date, except that no § 4965(a) excise tax applies with respect to income or proceeds that are properly allocable to any period ending on or before August 15, 2006 (TIPRA section 516(d)(1)). However, the increase in the entity-level tax imposed under § 4965(a)(1) on certain knowing transactions does not apply to any prohibited tax shelter transaction to which a tax-exempt entity becomes a party on or before May 17, 2006 (§ 4965(b)(1)(B)).

#### *VII. Effective Date for Disclosure Requirements and Related Penalties*

Q-20: What is the effective date for the disclosure requirements described above in Part V of this appendix and for the penalties for failure to comply with those requirements?

A-20: The new disclosure requirements described in Part V of this appendix, and the penalties for failure to comply with those requirements, apply to disclosures the due date for which is after May 17, 2006 (TIPRA section 516(d)(2)).