

OFFICE OF TAX SHELTER ANALYSIS (OTSA)

DISCLOSURE INITIATIVE - FAQs

1. What is the purpose of the Disclosure Initiative?

The Disclosure Initiative provides an opportunity for taxpayers to disclose their tax treatment of tax shelters and other questionable transactions for which the imposition of an accuracy-related penalty may be appropriate if there is an underpayment of tax. If the taxpayer discloses a transaction in accordance with the announcement within the 120-day opportunity period, the IRS will waive certain accuracy-related penalties under section 6662 of the Code.

2. Is the Disclosure Initiative and Penalty Waiver available only to large corporate taxpayers?

No, all taxpayers – corporate and non-corporate, large and small – may take advantage of this opportunity.

3. Why is the IRS offering this disclosure Initiative and Penalty Waiver?

The IRS believes that many taxpayers entered into questionable transactions based on the representations of financial advisors who marketed these transactions to them. These taxpayers are now aware that those transactions may be challenged upon an IRS audit and result in additional tax and penalties. However, they may be reluctant to voluntarily come forward and disclose the transactions because of the potential substantial penalties that may result.

The disclosure initiative gives these taxpayers a 120-day opportunity to voluntarily come forward and disclose the transactions without fear of incurring penalty. The IRS believes that voluntary disclosure of these transactions is good for our tax system and will improve tax administration.

4. What must be disclosed to ensure the waiver of penalties?

Disclosure must be in good faith and include the following:

- A statement describing the material facts of the item;
- A statement describing the taxpayer's tax treatment of the item;
- The taxable years affected by the item;
- If the taxpayer is a Coordinated Industry Case (CIC) taxpayer, a statement that the taxpayer will agree to enter into the Accelerated Issue Resolution (AIR) process described in Rev. Proc. 94-67, 1994-2 C.B. 800, if requested to do so by the IRS;
- The names and addresses of (i) all parties who promoted, solicited or recommended the taxpayer's participation in the transaction underlying the item and who had a

financial interest, including the receipt of fees, in the taxpayer's decision to participate, and (ii) if known to the taxpayer, parties who advised the promoter, solicitor or recommender with respect to that transaction;

- A statement agreeing to provide, if requested, copies of the following:
 - (a) all transactional documents, including agreements, contracts and other instruments, schedules, and, if the taxpayer's participation in the transaction was promoted, solicited or recommended by any other party, the name(s) of that party's advisors.
 - (b) All internal documents or memoranda used by the taxpayer in its decision-making process including, if applicable, information presented to the taxpayer's board of directors; and
 - (c) All opinions and memoranda that provide a legal analysis of the item, whether prepared by the taxpayer or a tax professional on behalf of the taxpayer.
- A penalty of perjury statement that the person signing the disclosure has examined the disclosure and that to the best of that person's knowledge and belief, the information provided in the disclosure contains all relevant facts and is true, correct and complete.

5. *What types of penalties will receive relief under the disclosure initiative?*

Only the accuracy-related penalty for certain situations under section 6662(b) of the Internal Revenue Code. Relief will be available for that portion of an underpayment attributable to the disclosed item and due to one or more of the following:

- (i) Negligence or disregard of rules or regulations;
- (ii) Any substantial understatement of income tax;
- (iii) Any substantial or gross valuation misstatement under Chapter One of the Code, except for any portion of an underpayment attributable to a net section 482 transfer price adjustment, unless the requirements of IRC § 6662 (e)(3)(B) are met (that is, the penalty will not be waived for valuation misstatements arising from transfer pricing situations in which taxpayers were required to maintain contemporaneous documentation); and
- (iv) Any substantial overstatement of pension liabilities.

The disclosure initiative will not affect any other civil penalty or the consideration, investigation, or recommendation regarding potential criminal conduct.

6. *What type of transaction does the IRS expect to be submitted under the disclosure initiative?*

The initiative covers tax shelter and other items for which the imposition of the accuracy-related penalty may be appropriate if there is an underpayment of tax. For example, if a taxpayer invested in a tax shelter that would result in a substantial understatement of income, a taxpayer could disclose under the initiative and avoid the accuracy-related penalty.

7. *Are any items specifically excluded?*

Yes, the following items are specifically excluded:

- (i) Transactions that did not in fact occur, in whole or in part, but for which the taxpayer claimed a tax benefit on its tax return, that is, factual shams;
- (ii) Transactions that involved the taxpayer's fraudulent concealment of the amount or source of any item of gross income, that is transactions involving fraud or criminal conduct ;
- (iii) Transactions in which the taxpayer concealed its interest in, or signature or other authority over a foreign financial account, for example, a transaction in which a taxpayer failed to indicate on its return its control over a foreign financial account and that the failure was for the purpose of concealing such account;
- (iv) Transactions in which the taxpayer concealed a distribution from, or a transfer of assets to a foreign trust, or that the taxpayer was a grantor of a foreign trust, for example, a transaction in which a taxpayer failed to indicate on its return that the taxpayer received a distribution from a foreign trust and the failure was for the purpose of concealing such distribution; and
- (v) Transactions that involved the treatment of personal, household, or living expenses as deductible trade or business expenses.

8. *If a corporate taxpayer has already filed a disclosure statement (for reportable transactions) with OTSA pursuant to Treasury Regulation § 1.6011-4T, does this in itself qualify the taxpayer to receive the penalty waiver?*

No! The requirements of the disclosure initiative are very extensive and the taxpayer will have to provide all information spelled out in the announcement in order to be considered for the penalty waiver. In addition, information provided must include, if requested, copies of all transactional documents, internal documents, opinions, memoranda, etc., as required by the announcement.

9. *Are taxpayers under any obligation to disclose transactions under the initiative?*

No! The disclosure initiative does not impose an affirmative obligation on taxpayers. Participation in this initiative is voluntary.

10. *Does a taxpayer's disclosure of a transaction create an inference that the taxpayer's tax treatment of the item was improper or that the accuracy-related penalty will apply if there is an underpayment of tax?*

No! A taxpayer's disclosure of an item creates no inference that the taxpayer's tax treatment of the item was improper or that the accuracy-related penalty would apply if there is an underpayment of tax.

11. Will the IRS automatically impose the accuracy-related penalty if there is an underpayment of tax and the taxpayer did not disclose the transaction under the disclosure initiative?

No! A taxpayer's decision to not disclose under the initiative creates no implication that the accuracy-related penalty will be imposed if there is an underpayment of tax. Examiners are expected to consider the accuracy-related penalty if there is an underpayment of tax. Fair and impartial consideration must be and is done on a case-by-case determination. Furthermore, taxpayers are (and will continue to be) given the opportunity to demonstrate that the penalty does not apply, including demonstrating that they acted with reasonable cause and in good faith with respect to the item.

12. If a taxpayer is currently under examination, but the examiner or audit team has not raised the issue, can the taxpayer make the disclosure and receive the penalty waiver?

Yes, a CIC taxpayer must submit the disclosure information to the assigned team manager and send a copy to OTSA. All other taxpayers must submit their information to the examiner and also send a copy to OTSA.

13. Does a small business taxpayer who is not currently under audit have to send a copy of the information to OTSA?

Yes. OTSA is the IRS contact point for this disclosure initiative and will coordinate within the IRS, among all operating divisions.

14. When is a transaction or issue under examination?

The following examples can be used as a guide:

- (i) The examiner provides the taxpayer with a list of audit areas he plans to examine and the list includes the specific issue. A reasonable person would conclude that the examiner was aware of the specific item and has communicated it to the taxpayer.
- (ii) The examiner has sent the taxpayer an appointment letter that includes a general request for books and records, bank statements, etc., but does not mention the specific issue. A reasonable person would conclude that the examiner has not communicated knowledge of the specific issue to the taxpayer.
- (iii) A team coordinator (TC) on a CIC audit has issued an information document request (IDR) concerning the specific transaction. A reasonable person would conclude that the TC is aware of the issue and has communicated that to the taxpayer.

15. Is the penalty perjury statement subject to negotiation with the IRS?

No, the penalty perjury statement must adhere to the requirements of the disclosure initiative announcement.

16. Can individual taxpayers have their CPAs sign the penalty of perjury statement for them?

No, the declaration must be made by the taxpayer, and no one else!

17. Are LMSB team managers required to make their assigned taxpayers aware of this disclosure initiative?

Yes, team managers are encouraged to provide copies of the announcement to their taxpayers and discuss the benefits of participation with them.

18. Does the filing of a corporate disclosure statement with OTSA in compliance with Treasury Regulation § 1.6011-4T prohibit a taxpayer from participating in the disclosure initiative?

No, merely filing a disclosure statement with OTSA does not mean that the transaction is under examination. Also, the IRS has not communicated with the taxpayer regarding the transaction.

19. Does a taxpayer with multiple transactions on its return have to file a disclosure statement for each transaction in order to benefit from the penalty waiver?

Yes, a taxpayer must submit a separate disclosure statement for each transaction in order to qualify for the penalty waiver.

20. If the taxpayer fails to provide all the information required by the disclosure initiative announcement, does this void the penalty waiver?

Yes. In order to receive the penalty waiver, the disclosure must conform to the requirements of the announcement. The examiner or team manager, in conjunction with OTSA will review the disclosure and give the taxpayer a reasonable opportunity to correct any deficiency in its disclosure.

21. If taxpayer representatives have questions regarding the disclosure initiative, whom may they contact?

Taxpayer representatives may contact Jozef Chilinski at (202) 283-8425, Dave Harris at (202) 283-8386, or the IRS Tax Shelter Hotline at 1-866-775-7474.