LMSB Combats Abusive Tax Avoidance Transactions

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Combating abusive tax avoidance transactions is a significant compliance priority for the Internal Revenue Service. Working with Treasury and the Office of Chief Counsel, the Large and Mid-Size Business Division (LMSB) has a multi-faceted strategy to deal with abusive corporate and technical tax avoidance transactions, commonly referred to as abusive tax shelters

- **A broad range of enforcement tools are in place to shed light on abusive transactions and take action against investors and promoters.**
  - The strategy encourages and, as necessary, enforces compliance with Treasury regulations that require registration, disclosure and investor identification.
  - Regulations require promoters to register certain shelters with IRS and maintain lists of investors in those transactions. Promoters are required to make investor lists available to IRS upon request.
  - Investigations are initiated against promoters to ensure their compliance with registration and list maintenance requirements.
  - Summonses are used in cases where promoters do not provide transaction or investor information as required by regulation.
  - Investors are required to disclose shelter positions they claim on their tax returns.
  - Investor case examinations include compliance and enforcement tools such as specially developed information document requests and procedures that require taxpayers to produce tax accrual work papers.
  - Promoters and investors can be subject to substantial civil penalties for their participation in abusive transactions.
  - As appropriate, IRS has also implemented "alternative" compliance initiatives to bring taxpayers into compliance.
  - Litigation is an important enforcement tool. Chief Counsel designates certain cases for litigation where the abusive transaction in question remains unresolved through normal examination and appeals processes. In this way, precedent is established from which IRS, investors and promoters can more clearly ascertain the proper tax consequences of the transaction and the outcome of unresolved like issues.

- **Timely analysis of transactions and published guidance enable proper and consistent tax treatment.**
  - The IRS and Treasury have addressed 29 abusive transactions in formal guidance. Publishing guidance as early as possible is intended to deter subsequent promotion and investment in the abusive transaction.
  - The abusive transactions covered by formal guidance cumulatively involve billions of dollars in claimed tax benefits.

- Abusive technical transactions are extremely complex and based upon technical distortions of existing law and regulation to generate unwarranted and substantial tax benefits. The guidance clearly articulates IRS and Treasury analysis and position.
- Published guidance also ensures consistent treatment of such transactions by IRS agents in the field.

- **LMSB is using enforcement techniques in dealing with some promoters.**
  - Abusive transactions are devised and marketed by tax professionals and promoters for large fees. These parties, typically well versed in matters of finance and taxation, often go to great lengths to structure and market the transactions in obscurity to avoid detection. This activity is contrary to Treasury regulations that require promoters to register certain tax shelters and make lists of investors available to IRS upon request.
  - Failure to comply with these regulations can result in penalties of 1% of the amount invested, which can be substantial in multi-million, or billion, dollar transactions.
  - Some promoters do comply with the regulations and IRS requests for information; many do not.
  - LMSB has completed 6 promoter investigations and has 135 approved or underway.
  - LMSB has over 125 agents working promoter cases; Counsel has over 75 attorneys involved in these cases.
  - In cases where promoters do not provide investor lists, IRS and Treasury may issue summonses. To date, 355 dual purpose administrative summonses have been issued to secure investor lists.
  - IRS seeks summons enforcement when promoters do not comply with a summons; 122 have been referred to the Justice Department for enforcement.
  - IRS also can seek approval from the U.S. District Court to serve "John Doe" summonses on promoters to secure investor identities. To date, five such summonses have been authorized in promoter investigations.

- **Investors in abusive transactions are increasingly being identified for audit.**
  - The LMSB strategy addresses investors' participation in abusive transactions through traditional examination processes and alternative issue resolution methods.
  - Since the start of 2002, LMSB has completed over 500 tax shelter examinations; and currently has over 4,000 underway or scheduled.
  - LMSB policy with respect to investor participation in abusive transactions requires agents to develop IRC § 6662 accuracy penalty assertions. This penalty equals 20% of the tax underpayment attributable to the abusive transaction.

- **LMSB considers alternatives to traditional compliance measures.**
  - LMSB has augmented the traditional compliance and enforcement processes with alternative methods to resolve outstanding transactions. Although not all issues lend themselves to an alternative resolution approach, two such initiatives have been conducted to date.

- The Disclosure Initiative, concluding in April 2002, encouraged investors to disclose their participation in abusive transactions. In exchange for voluntary disclosure, IRS waived certain penalties. The initiative resulted in 1,690 disclosures from 1,212 taxpayers, cumulatively involving claimed tax benefits amounting to billions of dollars. In addition to bringing these taxpayers into compliance, the information they disclosed provided leads to many promoters and emerging abusive transactions.
- The Settlement Initiative, concluded in March 2003, offered investors in certain abusive transactions equitable alternatives to protracted enforcement and litigation. The abusive transactions involved basis shifting, contingent liabilities and corporate owned life insurance. The settlement options offered these taxpayers were customized to the facts, circumstances and litigation hazards for each type of transaction and required substantial tax payment, and penalties as appropriate. Over 350 taxpayers applied for the settlements offered.
- Actual and anticipated tax assessments on these settlement initiative cases to date total over $1.3 billion.

- **LMSB has committed substantial resources to combat abusive transactions.**

  - LMSB devoted over 350 staff years in FY 2003 to combating abusive tax transactions through promoter investigations and taxpayer examinations. LMSB expects to devote 530 staff years to combating abusive tax transactions in FY 2004.
  - The Office of Tax Shelter Analysis (OTSA) provides centralized data collection and analysis services on all aspects of the tax shelter program, including information required by regulation, developed by field agents, and obtained during the course of our disclosure and settlement initiatives.
  - IRS teams are assembled to implement a comprehensive strategy to deal with identified questionable or abusive transactions. Each team is headed by an LMSB executive and includes representatives from Chief Counsel, technical advisors, field specialists and, as appropriate, other IRS operating divisions. Each team is charged with the responsibility of addressing all aspects of the issue, including technical analysis, need for published guidance, examination guidance for agents, applicability of alternative resolution options, and coordination across IRS divisions. In this manner, the unique characteristics and compliance needs inherent to each type of transaction can be addressed with precision and specificity.