FREQUENTLY ASKED QUESTIONS
SECTION 302/318 SETTLEMENT INITIATIVE

Administrative & Procedural

Q. If a Statutory Notice of Deficiency has been mailed to the taxpayer, but no petition has been filed with the U.S. Tax Court, is the settlement offer still available?

A. Yes, because technically there has been no lawsuit initiated by the Taxpayer in any court related to any tax year regarding this particular adjustment.

Q. Should we send a copy of the Announcement to the taxpayer*?*

A. Yes, Announcement 2002-97 can be provided to the Taxpayer.

Q. If a taxpayer does not meet the eligibility requirements, can the taxpayer still send a notification in writing that they wish to participate in the settlement initiative*?*

A. If the taxpayer sends correspondence indicating they wish to participate in the settlement correspondence should be initiated back to the taxpayer (with documentation to the case file) advising them why they are not eligible to participate.

Q. Is the Form 906 going to include language covering "innocent spouse" provisions?

A. No. Information relating to Innocent Spouse provisions will not be included in the Form 906. This type of situation will be handled on a case-by-case basis and based on the circumstances of the examination.

Q. Does the timely mailing timely filed rule apply to this December 3, 2002 deadline?

A. The taxpayer must notify the examining agent on or before 12/3/02 in writing. The Service will follow the timely mailing/timely filing provisions of I.R.C. 7502 with respect to settlement initiatives under Announcement 2002-97.

Q. What if the amount on the closed loss year return is minimal compared to the open loss year return?

A. Any year in which the Transactions are closed makes the taxpayer ineligible for the settlement.

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Administrative & Procedural

Q. Should we disallow all fees that were reported separately on the tax return that deal with this transaction?

A. Yes, because we are allowing Deemed Transaction costs.

Q. We are auditing the 1998 & 1999 years of a taxpayer that has 302/318 losses in both years. We have not competed the audit of the 1999 return that has other issues in addition to the 302/318 transactions. Can a closing agreement be solicited on the 1998 year first under the settlement initiative and the 1999-year closed out later with a separate closing agreement?

A. The closing agreement should incorporate all of the years that have the 302/318 issue. For the year that has issues other than 302/318, a partial assessment for the 302/318 issue should be made. In the example given above, the 1999 examination would still be open for other audit areas to be developed.

Q. If I don't have all the documents covered in the OTSA list of documents, does this mean that the Taxpayer does not meet the eligibility requirements?

A. See attached list documents. List for Strategy 1, 2 & 3. An IDR maybe required securing the documents.

Q. How do we treat the gain or loss from the warrant contract with the Foreign Corporation?

A. See example. Files are attached.

Q. On multi-year cases, what year are deductions taken for deemed transactions costs?

A. All deemed transactions costs should be taken in the first year when losses were taken because this is when most costs were actually incurred and when those costs incurred were agreed to.

Q. Are the amounts for the warrant or the call option (FC stock) or the equity swap amounts (be it gain or loss) to be left alone on the returns as filed or should agents make adjustments to eliminate their tax results?

A. Yes, all reported gains or losses from warrants/swaps are disregarded and eliminated from returns, since they are part of the deemed transactions costs.

FREQUENTLY ASKED QUESTIONS
SECTION 302/318 SETTLEMENT INITIATIVE

Penalty

Q. Does the DFO approve the penalties prior to the issuance of the RAR?

A. Prior to the issuance of the RAR, the District Field Operations (DFO) must approve assertion or non-assertion of a penalty.

Q. Please clarify the position on penalties?

A. We are neither directing agents to assert the penalty or not assert the penalty. Each case should be considered on its merits and the facts and circumstances surrounding each case. The only cases where the penalty will not be considered in the situation where the taxpayer qualified for waiver of the accuracy penalty under the Disclosure Initiative Announcement 2002-02.

Q. Is a DFO memo to concur with not asserting penalties required on cases where the taxpayer filed under the Disclosure initiative 2002-02?

A. In the situation where taxpayers have filed under Disclosure Initiative 2002-02, and the penalty will not be issued, a short memorandum is required to be included in the file identifying the DFO's concurrence with the non-assertion of the penalty.

Q. Agents have asked whether the Service will pursue cases in instances where the penalty was applied and the taxpayer has elected to take the settlement adjustment but challenge the penalty?

A. As stated in Announcement 2002-97, participating in the settlement initiative does not preclude taxpayers from contesting the application of penalties through normal audit and deficiency procedures. Therefore, the application or non-application of penalties will proceed without regard to whether the taxpayer participates in the settlement initiative.

FREQUENTLY ASKED QUESTIONS
SECTION 302/318 SETTLEMENT INITIATIVE

Penalty

Q. What penalties are applicable in the Section 302/318 cases? Should we apply The 40% substantial valuation misstatement penalty under IRC Section 6662-5, or the 20% penalty?

A. A substantial valuation misstatement exists if the value or adjusted basis of any property claimed on a return is 200% or more of the amount determined to be the correct amount of such value or adjusted basis. If the value or adjusted basis of any property claimed on a return is 400% or more of the amount determined to be the correct amount of such value or adjusted basis, the valuation misstatement constitutes a "gross valuation misstatement". If there is a gross valuation misstatement, then the 20% penalty under IRC 6662(a) is increased to 40%.

If the adjusted basis of Foreign Bank stock and options is 200% or more of the correct amount , than a substantial valuation misstatement exists; if the adjusted basis of Foreign Bank stock and options is 400% or more of the correct amount, then a gross valuation misstatement exists.

FREQUENTLY ASKED QUESTIONS
SECTION 302/318 SETTLEMENT INITIATIVE

TEFRA & Flow-Thru Entities

Q. If the taxpayer is a TEFRA Partnership, can we send a copy of the Announcement to the partners?

A. Yes, but please be aware that if the partnership is TEFRA and that is where the adjustment is coming from, you must do a partnership level proceeding. This requires all the standard TEFRA notices be issued to the Tax Matters Partner (TMP) and Notice Partners. If the statute is short or the agent has already completed the examination, we can issue the NBAP and FPAA together but must include what is formerly known as a "Hillcrest" letter which allows each partner to elect out of TEFRA.

Q. What if some partners want to take advantage of the settlement and the other don't? How does this affect the partnership?

A. If the partnership is TEFRA, partners may agree at any point in the TEFRA proceedings, the unagreed partners are allowed to go forward to Appeals and then the courts.

Q. When the Taxpayer (Grantor Trust) does not file a tax return, who will the closing agreement be signed by (Taxpayer or beneficiary or both)?

A. The grantor trust will be considered the Notice Partner and also a pass-through partner. Ultimately, the indirect partner, i.e. the beneficiary will sign the waiver.

Q. ***The settlement initiative calls for closing agreements to be entered into with Taxpayers who would like to accept the settlement offer. In the case of a TEFRA partnership, who would sign the Form 906 agreement?***

A. The TMP usually agrees to the F4605-A, but each notice partner must sign a waiver. In a Partnership of 100 or less partners, all partners are notice partners. If the partnership has more than 100 partners, all partners who have a 1% or greater profits interest are notice partners. The TMP may sign a waiver binding non-notice partners unless they provide notification that the TMP is not so authorized.