IRS Market Segment Specialization Program Audit Technique Guide: Examination Guide --Abusive Tax Shelters and Transactions

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IRS Audit Technique Guide: Examination guide: Abusive tax shelters and transactions: Market Segment Specialization Program.

Examination Guide --Abusive Tax Shelters and Transactions

March 2003

This guide was developed to support IRS field personnel in the identification and the consistent development of abusive tax shelter and transaction issues. The guuide covers transactions engaged in by all types of taxpayers, including "listed transactions" (known abusive), identified transactions that have not been listed, and emerging transactions.

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Part I - Purpose of Guide

I.A. Purpose

Purpose of Guide

This audit technique guide (ATG) was developed to support the field in the identification and the consistent development of abusive tax shelter issues. The ATG covers tax shelter transactions engaged in by all classes of taxpayers, including "listed transactions" (known abusive), identified transactions that have not been listed, and emerging transactions. The ATG will act as a central depository for Service-wide knowledge on examination of abusive tax shelters. The ATG will provide field personnel with one source to obtain the most current and pertinent information. The use of the ATG by field personnel will provide consistent treatment of similarly situated taxpayers.

In addition, development and use of the ATG will also reinforce the Service's commitment to dealing with abusive tax shelters.

This guide was created by various individuals that contributed information from their experience in dealing with tax shelters. The guide also includes information from existing position papers, technique guides, and CPE materials that deal with specific listed transactions and identified transactions that have not been listed. The ATG is not intended to replace any of these materials.

1.B. Abusive Tax Shelter History

The Legislative History of Abusive Tax Shelters

There have been extensive efforts in the attempt to curb Abusive Tax Shelters. Some of the historical highlights of these efforts follow.

In the 1950's through the early 1980's the courts dealt withλ the tax shelters, disallowing tax benefits and imposing penalties, but it was not completely effective - so a legislative solution was sought.

Congress' first substantive response was the Tax Reform Act ofλ 1976, which enacted the "at-risk" rules limiting individuals from claiming losses for certain investments for which they had limited economic risk.

In the Revenue Act of 1978, the at-risk rules were extended to aλ broader array of activities

The Economic Recovery Tax Act of 1981λ extended the at-risk rules still further.

Congress then passed the Taxλ Equity and Fiscal Responsibility Act of 1982 (TEFRA). This Act primarily contained procedural and penalty type changes.

Congress then passed theλ Deficit Reduction Act of 1984 which contained numerous provisions aimed at tax shelters.

--For the first time, it became necessary to register tax shelters with the IRS , which was designed to help the IRS locate and evaluate tax shelters, IRC §6111.

--Organizers and sellers of "potentially abusive tax shelters" also were required to maintain a list of investors in registered shelters, IRC § 6112

--Certain penalties were significantly strengthened, IRC §§ 6700, 6701, & 7408

Congress passed the Tax Reform Act of 1986.

--This law enacted the "passive loss" rules which prevent an individual (but not a corporation) from claiming a loss from an activity, unless the individual materially participated in the activity.

--The Tax Reform Act of 1986 greatly reduced tax shelters for individuals.

--Because of these changes in the law, the focus of tax shelter activity moved to the corporate arena, where the passive loss rules do not apply and the tax law is more complex.

Uruguay Round Agreements Act of 1994λ

--The ability of corporations to avoid the substantial understatement penalty for tax shelter items based on substantial authority and reasonable belief under IRC § 6662 was eliminated. Instead, corporations could avoid the penalty for tax shelter items only if they established reasonable cause under IRC § 6664(c).

Abusive Tax Shelter History in Recent Years

In 1997, Congress added IRC § 6111 to require the registration of confidential corporate tax shelters (IRC § 6111(d)).

In 1998, as part of the IRS Restructuring and Reform Act, Congress instructed the Joint Committee on Taxation (JCT) and Treasury to conduct studies of the present-law and interest provisions and make legislative or administrative recommendations. These studies, designed in part to propose methods to curb the activities of corporate tax shelters, included the JCT Penalty Study, JCX-84-99 (July, 1999), and the Treasury Department's studies included in the Treasury White Paper (July, 1999) and Penalty Study (October, 1999).

In addition, the IRS

(1) took administrative action designed to "shut down" certain identified tax shelters in which both corporations and individual taxpayers had invested; and

(2) established the Office of Tax Shelter Analysis (OTSA) to serve as the focal point in the war on tax shelters.

The Treasury Department also proposed regulatory changes to the standards of practice for tax practitioners that would impact the way they are able to advise tax shelter investors, (i.e. Circular 230).

Curbing Abusive Tax Shelters

The following were set in place in an effort to curb abusive tax shelters:

Regulations requiring that corporate taxpayers disclose on their tax returns investments in certain "reportable transactions" under IRC § 6011-4;

- Notice 2000-15, 2000-12 listing ten known abusive transactions, identified as "listed transactions".

- Rev. Rul. 2000-12, 2000-11 involving the IRS ' attempt to shut down debt straddle tax shelters; and

- Announcement 2000-12, which summarizes the new rules and announces the creation of OTSA to serve as the IRS ' focal point to gather and analyze information regarding the new registration, list maintenance and return reporting requirements for tax shelters, and to coordinate responses to the abusive tax shelter problem.

Chronology of Events in 2000

The following sections reflect the major activities in the corporate tax shelter area in 2000.

February 28, 2000

On this date, the IRS issued the following items of guidance in its efforts to regulate and curtail the use of abusive tax shelters:

Temporary and proposed regulations requiring the registration of confidential corporate tax shelters under IRC § 6111 (d)

Temporary and proposed regulations requiring the maintenance of lists of investors in investments in certain corporate tax shelters under IRC § 6112

Temporary and proposed regulations requiring corporate taxpayers to disclose on their tax returns investments in certain "reportable transactions" under Treas. Reg. 1.6011-4T

Notices 2000-15 which identifies ten different "listed transactions" for purposes of compliance with the above three sets of temporary and proposed regulations;

Rev. Rul. 2000-12 involving the IRS ' attempt to shut down debt straddle tax shelters; and

Announcement 2000-12, which provides a general description of the new rules and announces the creation of OTSA to serve as the focal point of the IRS ' efforts to combat abusive tax shelters.

May 11, 2000

The IRS issued a Notice of Proposed Rulemaking (NPRM) to amend Circular 230, which governs the standards of practice for all practitioners before the IRS (attorneys, accountants, and enrolled agents). One of the purposes behind this NPRM was to warn the law and accounting firms that put together tax shelter transactions, as well as the practitioners and chief financial officers who used them, that their professional reputations and fortunes might suffer if the rules were not followed. In the NPRM, which the IRS also published in the form of Announcement 2000-51, the IRS requested public comments on its intent to revise these standards, with particular focus on the proposals to amend the standards under which practitioners operated when preparing and issuing opinions on tax shelters.

May 24, 2000

The Senate Finance Committee released a bipartisan preliminary Staff Discussion Draft of legislative proposals designed to alter the cost-benefit analysis of corporations and other participants entering into corporate tax shelter transactions. This Discussion Draft also included proposals to amend the Circular 230 requirements concerning the provision of opinions on tax shelters. The proposals were incorporated into the Taxpayer Bill of Rights 2000 legislation, which was not enacted in 2000. However, since the general feeling in Congress is that there needs to be some statutory overhaul to accompany the executive and judicial branches' efforts in this area, these proposals still remain a first-order-of-business for Congress.

May 30, 2000

The IRS announced that the Office of Tax Shelter Analysis was up and running and ready to respond to questions, as well as to accept tips, "relating to potentially improper tax shelter activity by corporate and noncorporate taxpayers."

June 20, 2000

A hearing was held to air comments on the proposed and temporary regulations. Comments were received from a number of organizations, most notably the American Institute of Certified Public Accountants, the Tax Executives Institute, and the Chicago Bar Association, all of whom provided written comments and testified at the hearing. The common thread in all the comments was that the regulations had been drafted in a manner that was overly broad, and that they might lead to the targeting of individuals, businesses, and transactions that were merely involved in legitimate, everyday business transactions, and in permitted tax planning.

August , 2000

Notice 2000-44 was released which identified the "Son of Boss" transaction as a listed transaction.

October-November 2000

Another series of IRS rulings and Treasury warnings began. Included in this series of activities was:

- Notice 2000-60 was released attacking a series of transfers between a parent corporation and its subsidiary designed to create artificial losses for the parent by utilizing employee stock compensation arrangements. The IRS recharacterized the basis transfer from the subsidiary to the parent corporation as a dividend to the parent.

- Notice 2000-61 (along with a Treasury Department Press Release) disallowing an arrangement in which corporations and individuals had been marketed trusts in Guam on the premise that the trusts would be treated as individuals for tax purposes, and that income taxes would only be required to be paid in Guam (and not in the United States).

LMSB the IRS Administrative Action 2001

On September 6, 2001 the Large & Midsize Business Division (LMSB) of the IRS established a Tax Shelter Committee to serve as a sub-committee of its Compliance Strategy Council. The Tax Shelter Committee provides leadership in combating abusive tax shelters and is responsible for making key decisions in implementing LMSB's strategic initiative #5 dealing with tax shelters.

On December 10, 2001 LMSB established an IRC § 6700 Committee to serve as a sub-committee of the Tax Shelter Committee. This committee is charged with responsibility to approve all LMSB tax shelter promoter activities, including promoter contacts, investigations and penalties.

June 14, 2002

Temporary and Proposed regs. were issued modifying the rules on reporting and registering tax shelters under IRC §§6011, 6111, and 6112. The new regs. extend the disclosure requirements for listed transactions under §1.6011-4T to individuals, trusts, S corporations, and partnerships. The regs. also clarified the definition of "substantially similar" as taxpayers were construing the term in very narrow terms to avoid disclosure. The new regs. eliminated the "projected tax effect test", thereby requiring all corporations, individuals, trusts, partnerships and S corporations to disclose if they participate in a listed transaction.

Recent Information

A good way to keep up with recent tax shelter information is to research Tax Notes Today articles for recent "abusive tax shelter" articles. It is also important to check the "What's New" section of the OTSA web site.

1.C Characteristics of Corporate Tax Shelters

Introduction

Corporate tax shelters take many different forms and utilize many different structures. For this reason, a single comprehensive definition of corporate tax shelters is difficult to formulate. However, corporate tax shelters have the following characteristics:

- lack of meaningful economic risk of loss or potential for gain
- inconsistent financial and accounting treatment
- presence of tax-indifferent parties
- complexity
- unnecessary steps or novel investments
- promotion or marketing
- confidentiality
- high transaction costs
- risk reduction arrangements.

Lack of Meaningful Economic Risk or Potential for Gain

Professor Michael Graetz defined a tax shelter as "a deal done by very smart people that, absent tax considerations, would be very stupid." This definition highlights an important characteristic common to most corporate tax shelters, the lack of significant economic risk of loss or potential for gain to the taxpayer(s) seeking the tax benefit.

Often in corporate tax shelters, a corporate participant purportedly makes a significant investment. In most cases, however, the risk of loss or gain is illusory. Through hedges, circular cash flows, defeasances, and similar devices, the participant in a shelter is insulated from significant or all economic risk. Transactions with little or no economic risk typically generate little or no pre- tax profit. In light of the expectation of little or no pre-tax profit, no one rationally would participate in such transactions without significant tax benefits. After factoring in expected tax benefits, however, a negligible pre-tax profit is transformed into a significant after-tax return.

Corporate tax shelters can arise even in transactions that produce more than a negligible amount of pre-tax economic profit. For example, a taxpayer may attempt to disguise the tax avoidance nature of the transaction by placing high-grade, income-producing financial instruments in a corporate tax shelter.

Inconsistent Financial and Accounting Treatment

In recent corporate tax shelters involving public companies, the financial accounting treatment of a shelter item has been inconsistent with its federal income tax treatment.

A significant segment of corporate America has in recent years appeared to place a larger premium on tax savings, particularly tax savings in transactions where the tax treatment varies from the financial accounting treatment.

There is also a tendency for corporations to view their tax liability as just another cost of doing business that can be reduced through aggressive management. Shareholders expect corporate managers to keep the corporation's effective tax rate (i.e., the ratio of corporate tax liability to book income) low and in line with competitors.

A transaction that reduces both a corporation's taxable and book income lowers the corporation's tax liability, but does not affect its effective tax rate. More importantly, where there is a book loss the corporation could fail to meet the earnings expectations of investors. Executives will generally pass on an opportunity to reduce taxes if it also entails a reduction in reported earnings.

Although some disclosure of book-tax disparities is required for both federal income tax and GAAP purposes, the amount of detail required is limited and provides little evidence concerning the existence of corporate tax shelters. Financial statement disclosure is limited to items of materiality. Tax return disclosure is not limited to corporate tax shelters, but rather applies to all book-tax differences. Therefore, book-tax differences attributable to shelters often remain hidden and corporations have no incentive to voluntarily disclose the existence and nature of their shelters.

Presence of Tax-indifferent Parties

A significant characteristic found in many corporate tax shelters is the participation of tax-indifferent parties. Recent examples of shelter transactions that relied on the use of tax-indifferent parties include:

fast-pay preferred stock transactions,

LILO transactions, and

contingent installment sales transactions.

Tax-indifferent parties are accommodation parties that are paid a fee or an above-market return on investment for absorbing taxable income or otherwise "leasing" their tax-advantaged status. Tax-indifferent parties may include:

foreign persons,

Native American tribal organizations,

tax-exempt organizations (e.g., charitable organizations and pension plans), and

domestic corporations with net operating losses or credit carry-forwards that they do not expect to use to offset their own income.

When taxpayers use different methods of accounting, the difference may be arbitraged to create a tax shelter. For example, taxpayers subject to mark-tomarket accounting have acted as accommodation parties in tax shelters because they are indifferent to the realization principle and can absorb the gains of taxpayers.

Complexity

Corporate tax shelters typically involve complex transactions and structures. This complexity arises from a number of sources. Corporate tax shelters often require the completion of certain formalistic steps to gain the desired tax result. The use of certain entities or structures may be necessary to achieve the desired tax result or to facilitate the use of tax-indifferent parties. Other steps may be added to establish or buttress a claim of business purpose or economic substance. Also, corporate tax shelters often use innovative financial instruments to facilitate the exploitation of tax law inconsistencies.

Financial innovation is growing rapidly and the tax law has not kept pace. Many of the rules governing financial instruments were developed in the early part of the 20th century to deal with financial instruments common at the time, such as plain vanilla stock, debt, and short-term options. Modern-day sophisticated financial products do not fit neatly into the existing regimes. Consequently, taxpayers exploit the uncertainty regarding the taxation of these instruments, by creating the economic equivalent of a traditional investment without the unfavorable tax consequences. Once inconsistencies are identified, they frequently are manipulated.

The use of a complex structure may also be used as a device to cloak the tax shelter transaction from detection.

Unnecessary Steps or Novel Investments

Corporate tax shelters may involve:

unnecessary steps implemented to achieve the corporation's purported business purpose, or

property or transactions that the corporate participant either has little or no experience with, or

transactions that lack a bona fide business purpose.

A taxpayer generally must demonstrate a business purpose for entering into a transaction (or series of transactions) in order to sustain the claimed tax results. In many cases, however, certain steps are undertaken solely to obtain the desired tax benefits and are not necessary for the taxpayer to achieve the purported business purpose.

Some corporate tax shelters may involve new activities that the corporation had not in the past been a party to or used, such as:

leasing transactions,

novel financing arrangements,

tax-indifferent party transactions, or

REIT transactions.

On the other hand, some corporate tax shelters involve activities that fall within the corporation's normal business operations. Many of the participants are publicly traded conglomerates involved in a host of diverse activities, including financing transactions. Many corporate tax shelters involve financing transactions. Tax-indifferent parties, particularly pension plans and foreign persons are a major source of corporate finance. Some corporations that are active in the trade or business of financial intermediation (e.g., banks or insurance companies) also participate in tax shelters involving financing transactions. The fact a transaction is not "novel" for the taxpayer is not necessarily determinative of whether it is a corporate tax shelter.

Promotion or Marketing

Tax advisors are no longer just devising specific strategies to deal with their client's tax needs as they arise. Today's tax shelter promoters capitalize on complexities in the tax law (statute, regulations, and rulings) to devise schemes that can be pitched to corporate prospects. Tax shelter promoters sell their schemes methodically and aggressively as "products," using a powerful distribution network.

Many tax shelters are designed today so that they can be used by different investors, rather than addressing the tax planning of a single taxpayer. This allows the shelter "product" to be marketed and sold to many different clients, thereby maximizing the promoter's return from its shelter idea.

There are various ways in which promoters become aware of corporations who have a need for shelter transactions. For example, promoters may work with corporations in other capacities, such as underwriters, legal advisors, consultants, or auditors and learn of events that give rise to tax planning. Using this knowledge, the advisor can communicate the needs of their clients to other members of their firm who have expertise in designing corporate tax shelters. In addition, some corporations that generate significant profits are known to have an interest in transactions that can reduce the tax liability on such profits. Frequently, promoters approach people that they know have realized large gains.

New technologies have greatly increased the distribution and marketing of shelters. In the past, it may have taken weeks or months to distribute a corporate tax shelter nationwide, now it takes a matter of minutes.

Confidentiality

Like marketing, maintaining the confidentiality of a tax shelter transaction helps to maximize the promoter's return from its shelter idea.

A promoter has no generally enforceable intellectual property rights in the tax shelter idea. The idea can be expropriated, not only by the company shown the shelter, but also by any other prospective purchaser that finds out about the shelter. Promoters attempt to limit expropriation by requiring confidentiality agreements from prospective purchasers and their advisors.

Before pitching tax shelter ideas to prospective participants, promoters may require non-disclosure agreements that provide for million dollar payments for any disclosure of their "proprietary" advice. These arrangements limit but do not preclude the expropriation of the idea by other promoters.

Confidentiality agreements serve another essential purpose for promoters. Confidentiality agreements protect the efficacy of the idea by preventing or delaying its discovery by the Treasury Department and the IRS . Congress was concerned that confidentiality agreements would hinder tax administration. Therefore, in 1997 Congress expanded the tax shelter registration requirements to cover "confidential" corporate tax shelters. One of three conditions for registration is that some one other than the taxpayer has a proprietary interest in the arrangement or can prohibit the taxpayer from disclosing the arrangement.

It is unlikely that limiting confidentiality agreements alone will greatly impact the corporate tax shelter market. In lieu of formal confidentiality agreements, many promoters already rely on tacit understandings or other arrangements requiring a prospective participant to use the law firm selected by the promoter to protect their proprietary interest and reduce the risk of detection.

High Transaction Costs

Corporate tax shelters carry unusually high transaction costs that are borne in whole or substantial part by the corporate beneficiary. For example, the reported transaction costs in ASA ($24,783,800) were approximately 26.5 percent of the purported tax savings (approximately $93,500,000). Transaction costs include:

fees paid to the promoter,

fees paid to the tax-indifferent party,

fees for legal services (e.g., tax opinions and drafts of organizational documents and financial instruments,), and

expenses incurred in connection with the shelter activity.

Risk Reduction Arrangements

Corporate tax shelters often involve contingent or refundable fees in order to reduce the cost and risk of the shelter to the participants. In a contingent fee arrangement, the promoter receive a portion (often as much as one-half) of any tax savings realized by the corporate participant. If no tax savings are realized, the promoter gets nothing. Although tax return preparers are precluded from charging contingent fees in connection with the preparation of a tax return, there is generally no prohibition on charging contingent fees in connection with providing tax-planning advice. Similarly, under a refundable fee arrangement, a promoter would agree to refund its fee to a client whose tax benefits are not realized because of IRS challenge or a change in the law.

Corporate tax shelters may also involve insurance or rescission arrangements. Like contingent or refundable fees, insurance or rescission arrangements reduce the cost and risk of the shelter to the participants. These arrangements provide the corporate participant with some measure of protection in the event the expected tax benefits do not materialize. In a claw back or rescission arrangement, the parties to the transaction agree to unwind the transaction if the purported tax benefits are not realized. Often there is a so-called "trigger" event, such as a change in law or an IRS audit that is determined by an independent third party to constitute a significant risk to the tax benefits of the transaction. If the trigger event occurs, the transaction is unwound. The unwinding may take the form of the liquidation of any entity formed for purposes of the tax shelter, the redemption of any securities issued pursuant to the shelter, or the termination of any contractual agreements. By utilizing a recession arrangement or claw back, the corporate participant is not burdened with any complex or costly financial or legal structures that were part of the design of the suddenly defunct tax shelter. An example of an unwound transaction is the fast-pay preferred stock transactions that provided for the tax-free unwind of the REIT structure through liquidation of the REIT.

1.D.1. Introduction to Listed Transactions

Introduction

A "listed transaction" is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction for purposes of IRC §6011. (Treas. Reg. 1.6011-4T(b)(2).)) See also §301.6111-2T(b)(2) of the Procedure and Administration Regulations.

Announcement 2000-12

Announcement 2000-12 publicized the three sets of temporary and proposed tax shelter regulations and it also announced the creation of the Office of Tax Shelter Analysis. These tax shelter regulations require promoters to register confidential corporate tax shelters ***(Treas. Reg. § 301.6111-2T)*** and maintain lists of investors ***(Treas. Reg. §301.6112-1T)***. In addition, the regulations require corporate taxpayers to disclose reportable transactions including listed transactions ***(Treas. Reg. §1.6011-4T).*** (NOTE: These temporary regulations were revised in August 2001 and again in June 2002.) These temporanry and proposed regulations were issued in conjunction with Notice 2000-15 which identified the first group of "listed transactions".

(See *Announcement 2000-12*)

http://Announcement 2000-12.irs.gov/hq/pftg/otsa/downloads/publications/Announcement%202000-12.pdf

Notice 2000-15 and Notice 2001-51

Notice 2000-15 identified 10 transactions as listed transactions. Notice 2001-51 provided a compilation of all listed transactions as of August 2001. This Notice supplemented and superceded Notice 2000-15.

For additional details, go to Notice 2000-15 and Notice 2001-51
http://lmsb.irs.gov/hq/pftg/otsa/downloads/publications/Notice%202000-15.pdf

http://hqnotes1.hq.irs.gov/tnt3.nsf/8525609e004b88e386255f8900485f65/6ed c439d3685093185256a9d000a9998?OpenDocument

Known Abusive Tax Shelter Arrangements

I.D.2. Listed Transactions

Notice 2001-51

Notice 2000-15, issued February 2000, published the first ***list*** of transactions that were determined to be tax avoidance transactions. Notice 2001-51 was issued in August, 2001. This Notice restated the list of transactions identified in Notice 2000-15 as "listed transactions" effective February 28, 2000, and updated the list by adding transactions identified in notices released subsequent to February 28, 2000. Notice 2001-51 follows:

"On February 28, 2000, the Internal Revenue Service issued Notice 2000-15, 2000-12 I.R.B. 826, identifying certain transactions as "listed transactions" for purposes of § 1.6011-4T(b)(2) of the temporary Income Tax Regulations and § 301.6111-2T(b)(2) of the temporary Procedure and Administration Regulations. This notice restates the list of transactions identified in Notice 2000-15 as "listed transactions" effective February 28, 2000, and updates the list by adding transactions identified in notices released subsequent to February 28, 2000. Transactions that are the same as or substantially similar to transactions de-scribed in the list below have been deter-mined by the Service to be tax avoidance transactions and are identified as "listed transactions" for purposes of § .6011-4T(b)(2) and § 301.6111-2T(b)(2). As a result, corporate taxpayers may need to disclose their participation in these listed transactions as prescribed in § 1.6011-4T, and promoters (or other persons responsible for registering tax shelter transactions) may need to register these transactions under § 301.6111-2T. In addition, promoters must maintain lists of investors and other information with respect to these listed transactions pursuant to § 301.6112-1T.

(1) Rev. Rul. 90-105, 1990-2 C.B. 69 (transactions in which taxpayers claim deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the taxable year (identified as "listed transactions" on February 28, 2000));

(2) Notice 95-34, 1995-1 C.B. 309 (certain trust arrangements purported to qualify as multiple employer welfare benefit funds exempt from the limits of § 419 and 419A of the Internal Revenue Code (identified as "listed transactions" on February 28, 2000));

(3) Notice 95-53, 1995-2 C.B. 334 (certain multiple-party transactions intended to allow one party to realize rental or other income from property or service contracts and to allow another party to re-port deductions related to that income (often referred to as "lease strips") (identified as "listed transactions" on February 28, 2000));

(4) Part II of Notice 98-5, 1998-1 C.B. 334 (transactions in which the reasonably expected economic profit is insubstantial in comparison to the value of the expected foreign tax credits (identified as "listed transactions" on February 28, 2000));

(5) Transactions substantially similar to those at issue in *ASA Investerings Partnership v. Commissione*r, 201 F.3d 505 (D.C. Cir. 2000), and *ACM Partnership v. Commissione*r, 157 F.3d 231 (3d Cir. 1998) (transactions involving contingent installment sales of securities by partner-ships in order to accelerate and allocate income to a tax-indifferent partner, such as a taxexempt entity or foreign person, and to allocate later losses to another partner (identified as "listed transactions" on February 28, 2000));

(6) Treas. Reg. § 1.643(a)-8 (transactions involving distributions described in §1.643(a)-8 from charitable remainder trusts (identified as "listed transactions" on February 28, 2000));

(7) Rev. Rul. 99-14, 1999-1 C.B. 835 (transactions in which a taxpayer purports to lease property and then purports to immediately sublease it back to the lessor (that is, lease-in/lease-out or LILO trans-actions) (identified as "listed transactions" on February 28, 2000));

(8) Notice 99-59, 1999-2 C.B. 761 (transactions involving the distribution of encumbered property in which taxpayers claim tax losses for capital outlays that they have in fact recovered (identified as "listed transactions" on February 28, 2000));

(9) Treas. Reg. § 1.7701(l)-3, (transactions involving fast-pay arrangements as defined in § 1.7701(l)-3(b) (identified as "listed transactions" on February 28,2000));

(10) Rev. Rul. 2000-12, 2000-11 I.R.B. 744 (certain transactions involving the acquisition of two debt instruments the values of which are expected to change significantly at about the same time in opposite directions (identified as "listed transactions" on February 28, 2000));

(11) Notice 2000-44, 2000-36 I.R.B. 255 (transactions generating losses resulting from artificially inflating the basis of partnership interests (identified as "listed transactions" on August 11, 2000));

(12) Notice 2000-60, 2000-49 I.R.B. 568 (transactions involving the purchase of a parent corporation's stock by a subsidiary, a subsequent transfer of the purchased parent stock from the subsidiary to the parent's employees, and the eventual liquidation or sale of the subsidiary (identified as "listed transactions" on November 16, 2000));

(13) Notice 2000-61, 2000-49 I.R.B. 569 (transactions purporting to apply § 935 to Guamanian trusts (identified as "listed transactions" on November 21, 2000));

(14) Notice 2001-16, 2001-9 I.R.B. 730 (transactions involving the use of an intermediary to sell the assets of a corporation (identified as "listed transactions" on January 18, 2001));

(15) Notice 2001-17, 2001-9 I.R.B. 730 (transactions involving a loss on the sale of stock acquired in a purported § 351 transfer of a high basis asset to a corporation and the corporation's assumption of a liability that the transferor has not yet taken into account for federal in-come tax purposes (identified as "listed transactions" on January 18, 2001)); and

(16) Notice 2001-45, 2001-33 I.R.B. 129 (certain redemptions of stock in transactions not subject to U.S. tax in which the basis of the redeemed stock is purported to shift to a U.S. taxpayer (identified as "listed transactions"

on July 26, 2001)).

Power Point Presentations for all of the above can be found at
http://lmsb.irs.gov/hq/pqi/quality/taxshelter_ppt.htm

(1) Rev. Rul. 90-105 (Deferred Contribution Plan)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC § 401(k) and (m).

Summary of Transaction:

This is a transaction in which a taxpayer claims deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the taxable year

Shelter Transaction Result:

Deductions were claimed for the entire amount of elective and matching contributions to the Plan even though a portion of the deduction related to Post-Year End Contributions.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM 's, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the Technical Advisor (TA) for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

a. If the payment of the contributions is attributable to compensation earned after the end of the taxable year, under Treas. Reg. §1.404(a)-1(b), the Post-Year End Contributions could not be deductible.

b. If the taxpayer uses the accrual method of accounting, the requirements of IRC § 461(a) also have to be met.

Rev. Rul 2002-46 (which is discussed later in this ATG) describes a transaction substantially similar to Rev. Rul. 90-105.

Link to Rev. Rul. 90-105

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Rev Rul 90-105.pdf

Notice 95-34 (VEBA)

Summary of the Transaction's Tax Consequences

This is a transaction based on an improper interpretation of IRC § 419A(f)(6) for 10-or-more employer plans.

Summary of Transaction:

In general, contributions to a welfare benefit fund are deductible when paid, but only if they qualify as ordinary and necessary business expenses of the taxpayer and only to the extent allowable under IRC §§ 491 and 419A.

IRC § 491A(f)(6) provides an exemption from IRC §§ 419 and 419A for certain "10-or-more employer plans". For a plan to qualify for this exemption, each employer can contribute no more than 10 percent of the total contributions and the plan cannot be experience rated for individual employers.

Notice 95-34 applies to a variety of 10-or-more employer plan abuses. In some transactions, promoters create trusts that enroll at least 10 employers but which formally or informally are experience rated for each participating employer. Thus, some plans maintain separate accounting of the assets attributable to the contributions by each employer. In other situations, an employer's contributions to the plan are related to the claims experience of that employer's employees.

Shelter Transaction Result:

Deductions for the payments to these funds are improper, thereby reducing the employer and employee's income because only limited amounts contributed to the proper plans are includible in the employee's income.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM 's, court cases, etc. which may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for the transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled "Technical Advisors"

The IRS will challenge the plans for one or more of the following reasons:

a. The arrangements are actually providing deferred compensation.

b. The arrangements may be, in fact, separate plans maintained for each employer or may be experience rated with respect to individual employers in form or in operation. See e.g. Booth v. Commissioner, 108 T.C. 524 (1997) (concluding the plan at issue was an aggregation of separate welfare benefit plans, each of which had an experience rating arrangement with the contributing employer)

c. The employer contributions may represent prepaid expenses that are nondeductible under other sections of the Code

d. The employer's contributions are nondeductible because they are shareholder expenses. See e.g. Neonatology Assoc. P.A. v. Commissioner, 115 T.C. 43 (20002), aff'd. 2002 U.S. App. LEXIS 15236 (3d Cir. July 11, 2002) (the amounts contributed to the plan were not ordinary and necessary business expenses and the amounts were dividends of the plan participants rather than compensation).

Link to Notice 95-34

http://www.benefitslink.com/ IRS /notice95-34.shtml

(3) Notice 95-53 (Lease Strips)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC §§ 269, 351, 382, 446, 482, 701, 704, 7701 and Treas. Reg. § 1.61-8(b).

Summary of Transaction:

These transactions are designed to improperly separate income from related deductions by allocating rental or other income from property or service contracts to a tax-neutral party (someone who is not subject to federal income tax or has available net operating losses) while allocating the deductions related to this income (such as depreciation or rental expenses) to someone who expects to have income subject to federal income tax.

As described in Notice 95-53, stripping transactions are multiple-party transactions that take a variety of forms. In one typical version, the tax neutral party purports to accelerate the income from a stream of future rents by selling the right to the rents to a bank. The tax-neutral party then transfers its interest in the leased asset to someone who expects to have income subject to federal income tax in a transaction in which the transferee receives the tax neutral's basis in the asset. The transferee then claims depreciation o the asset. In another typical version, the tax-neutral party transfers a leasehold interest consisting of an obligation to pay rent and the proceeds of a rent sale. In this version, the transferee uses the proceeds from the rent sale to pay the rent obligation and reports real deductions.

Shelter Transaction Result:

a. Tax-neutral party reports the income from property or service contracts.

b. Another party claims the rental expense or depreciation deductions related to that income to shelter income that would otherwise be subject to federal income tax.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's as signed to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

a. Depending on the circumstances, the following Code and Regulation sections may also be applied: §269, §382, §446(b), §701, or §704,

b. authorities that recharacterize certain assignments or accelerations of future payments as financings,

c. assignment-of-income principles;

d. the business-purpose doctrine,

e. the substance-over-form doctrines (including the step transaction and sham doctrines),

Link to Notice 95-53

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 95-53.pdf

f. The deductions are not allowable because the stripping transaction lacked economic substance and business purpose, because they are capital expenses, or because the transaction in which the other party obtained the asset did not qualify as a transaction in which the tax neutral party's basis transferred to the other party.

g. *Andantch LLC v. Commissioner,* T.C. Memo 2002-97 holding that lease strips lacked economic substance and *Nicole Rose Corp. v. Commissioner*, 117 T.C. 328 (2001) holding that intermediary transaction in which loss was created by a lease strip that lacked economic substance.

Transactions in Part II of Notice 98-5, 1998-1 (ADR & other types)

Summary of the Transaction's Tax Consequences

These are transactions based on the use of IRC §§ 901 through 907 and 960.

Summary of Transaction:

Used to generate foreign tax credits, the first class of transaction involves a transfer of tax liability through the acquisition of an asset that generates an income stream subject to foreign gross basis taxes such as withholding taxes. These transactions may include acquisitions of income streams through securities loans and acquisitions in combination with total return swaps.

The second class of transaction consists of cross-border tax arbitrage transactions that permit effective duplication of tax benefits. Duplicate benefits result when the U.S. grants benefits and, in addition, a foreign country grants benefits to separate persons with respect to the same taxes or income.

Shelter Transaction Result:

a. In this first class of transactions, foreign tax credits are effectively purchased by U.S. taxpayer in an arrangement where the expected economic profit is insubstantial compared to the foreign tax credits generated.

b. In this second class of transactions, the U.S. taxpayer exploits these inconsistencies where the expected economic profit is insubstantial compared to the foreign tax credits generated. These duplicate benefits generally can result where the U.S. and a foreign country treat all or part of a transaction or amount differently under their respective tax systems.

Transactions in Part II of Notice 98-5, 1998-1 (ADR & other types)

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

a. Foreign tax credits will be disallowed under the authority of IRC §§ 901, 901(k)(4), 904, 864(e)(7), 7701(1), and 7805(a). See:

1. Compaq Computer Corp. v. Commissioner, 277 F.3d 778 (5th Cir. 2001) rev'g. 113 T.C. 214 (1999)

2. IES Industries v. United States, 253 F.3d 350 (8th Cir. 2001) reversing in part and affirming in part 1999 U.S. Dist. LEXIS 22610 (N.D. Iowa 1999)

Link to Notice 98-5

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 98-5.pdf

(5) ASA Investerings Partnership

Summary of the Transaction's Tax Consequences

This transaction involves IRC §453, which governs taxation of proceeds from an installment sale of property when the value of the installment payments is not known in advance.

Summary of Transaction:

Appellant domestic corporation (domestic appellant) anticipated huge capital gains from selling its interests in a particular company. To reduce the tax liability that would result, domestic appellant formed appellant partnership with two foreign corporations (foreign appellants) that were created specifically to facilitate domestic appellant's tax reduction plan. By design, foreign appellants, tax-exempt entities, owned vastly greater interest in appellant partnership when the income was received.

Shelter Transaction Result:

The partners' interests shifted so domestic appellant owned a vastly greater interest when losses were incurred.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Appellant partnership was formed purely to reduce domestic appellant's tax liability; therefore, it was not a separate taxable entity and its income was attributable to domestic appellant. The Tax Court agreed with the Commissioner that ASA was not a valid partnership for tax purposes, and thus did not reach the economic substance argument. See:

1. Saba Partnership v. Commissioner, 272 F.3d 1135 (D.C. Dir. 2001) vacating and remanding T.C. Memo 1999-359

2. ASA Investerings Partnership v. Commissioner, 201 F.3d 505 (D.C. Cir.2000) aff'g T.C. Memo1998-305, cert.denied 531 U.S.871 (2000)

3. ACM Partnership v. Commissioner, 157 F.3d 231 (3d Cir. 1998), aff'd. in part and rev'g in part T.C. Memo 1997-115m cert denied, 526 U.S. 1017 (1999)

4. Boca Investerings Partnership v. Comm., 167 F. Supp 167 F. Supp.2d 298 (D.C. 2001).

Link to Investerings Case

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/ASA Investerings - United States Court of Appeals.pdf

(6). Treas. Reg. § 1.643(a)-8 (Charitable Remainder Trusts(CRT))

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC §§ 170, 2055, 2106, 2522, 644 and 643

Summary of Transaction:

Taxpayer (TP) contributes appreciated asset that has negligible basis to CRT . Asset is monetized by CRT (e.g., borrows, enters into a prepaid forward contract, issues a security secured by the asset) in a way that does not cause the CRT to recognize income for tax purposes. Cash is distributed to the taxpayer. Since CRT distributions are taxable income to TP only to the extent CRT has taxable income, Taxpayer has no taxable income on the distribution. CRT terminates and TP takes charitable deduction on the remainder interest of the CRT . After the CRT terminates, the contract that monetized the asset is terminated by the charity.

Shelter Transaction Result:

Taxpayer receives cash equal to large part of the appreciation of asset that was distributed to CRT , has a charitable deduction equal to the discounted Fair Market Value of the remainder interest, and pays no income tax. In effect, the taxpayer has avoided paying gain on the sale of an appreciated asset and has also received a charitable deduction.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Distributions from the trust are treated as sales under IRC §1.643(a)-8.

Link to Treas. Reg. §1.643(a)8

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Prop Treas Reg 1-643(a)-8.pdf

Link to Technical Advisor's Training Material

http://abusiveshelter.web.irs.gov/Training/trainin.asp

(7) Rev. Rul. 99-14 (LILOs)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of Code and Reg. Sec.: §162 and §163.

Summary of Transaction:

A Foreign Municipality (FM) owns outright a facility that it has historically owned and used. A U.S. Corporation leases the facility from the municipality under a head lease, and simultaneously subleases it back to the municipality with an option on the part of the sublessee to renew or buy its way out of the head lease. Corporation pre-pays a portion of its rent obligation under the head lease. The Corporation funded its prepayment of the head lease with bank loans. FM defeases some or all of its sublease rents by depositing a portion of corporation's prepayment in bank(s). The debt service on corporation's loans is offset by rents received from FM under the sublease, and the risks of nonpayment on the loan and the sublease were defeased by circular pledges of security. Also, the Corporation's exposure to the lease residual was rendered insignificant by the Municipality's option to purchase that residual and a pledge of securities that defeased the FM's option payment.

(Note: While the Revenue Ruling refers to a Foreign Municipality, thee are Domestic municipalities that have done LILO transactions as well.

Shelter Transaction Result:

a. Corporation takes an interest deduction;

b. Corporation takes a rent deduction.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

a. A taxpayer may not deduct, under sections §162 and §163, rent and interest paid or incurred in connection with a LILO transaction that lacks economic substance.

Link to Rev. Rul. 99-14

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Rev Rul 99-14.pdf

Link to Technical Advisor's Training Material

http://lmsb.irs.gov/hq/pftg/leasing/downloads/Training/lilo_reference_guide/li lo_reference_guide_index.htm

Notice 99-59 (Boss)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC §§ 301, 475(f), and Treas. Reg. § 301.7701-3(c).

Summary of Transaction:

TP contributes cash to a foreign corporation (FP) in exchange for common stock in that corporation. Another party contributes capital to FP for preferred stock. FP borrows money from bank and grants bank an interest in the securities acquired by FP with the borrowed funds. FP distributes the encumbered securities to TP. TP disposes its of stock in FP.

Shelter Transaction Result:

Distribution of the encumbered securities to TP and related fees and transaction costs has the effect of reducing the fair market value of FP's common stock to zero. Since the distribution on the common stock is subject to the bank debt, TP claims that under IRC § 301(b)(2), the amount of the distribution is zero for purposes of IRC § 301. Therefore, the distribution to TP is treated as neither a dividend nor as a reduction of stock basis under IRC § 301(c). However, the distribution is done with the understanding that FP (which still has assets) will repay the money borrowed from the bank. Thus TP takes the securities tax free and claims a loss on its disposition of FP common stock. When TP disposes of common stock, TP takes loss equal to the original basis in stock over the FMV of the common stock. The TP's disposition of the common stock may be based upon an election under Treas. Reg. § 301.7701-3(c), or by treating the partnership as a trader in securities through using an election under IRC § 475(f). TP claims a tax loss while suffering no economic loss.

Link to Notice 99-59

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 99-59.pdf

Link to Technical Advisor's Training Materials

http://lmsb.irs.gov/hq/pftg/p_ships/training.htm

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Losses can be challenged under IRC §§ 269, 301, 331, 446 475, 482, 752, and 1001.

Link to Partnership Guide:

http://lmsb.irs.gov/hq/pftg/p_ships/downloads/Training/partnership_atg.pdf

(9) Treas. Reg. § 1.7701(1)-3 (Step Down Preferred)

Summary of the Transaction's Tax Consequences

These transactions are designed to allow a person (the sponsor) to avoid tax on substantial amounts of income (or to shelter substantial amounts of other income) by using a conduit entity whose income tax treatment artificially allocates the conduit entity's income to participants (holders of fast pay stock) that are not subject to federal income tax.

Summary of Transaction:

A corporate sponsor creates a subsidiary; often as a REIT, RIC or foreign corporation (conduit entity) (i.e. "Company"), which issues two classes of stock, fast pay preferred stock and common stock. Persons that are not subject to federal income tax hold the fast pay preferred stock. The corporate sponsor holds substantially all of the common stock (benefited shareholders). During the first 10 or so years of the transactions, income on the assets held by the REIT are treated as dividends that are paid to the holder of the fast pay preferred stock, while the holders of the common stock receive insignificant or no distributions and report no income. As an economic matter (but not as a tax matter) the fast pay shareholders' interest in the company declines as the dividends are paid on the stock. After approximately 10 years, the fast pay shareholders' interest in the company has declined to a de minimis amount without any reduction in their bases in the fast pay stock. According to an agreement made at the inception of the transaction, the income on the assets held by the REIT begin to be treated as dividends that are paid to the holder of the common stock rather than the fast pay preferred stock. Generally when this occurs, the Company is merged with the corporate sponsor and receives all of the company's assets.

Shelter Transaction Result:

During the first 10 years of the transaction, the corporate sponsor that holds the common stock reports no income. However, the sponsor's investment has preformed economically like a zero-coupon investment that substantially increases in value as the exempt participants' interest in the Company declines. In the eleventh year or so of the transaction, the Company mergers with the corporate sponsor and receives all of the company's assets. Since the Company's basis is high (value of assets have not decreased), the corporate sponsor avoids recognizing any gain.

Under §1.7701(1)-3, the multiple-party financing transaction may be recharacterized as a transaction directly between the benefited shareholders and the fast pay shareholders. The inception and resulting relationships of the recharacterized arrangement are deemed to be as follows:

(i) *Relationship between benefited shareholders and fast-pay shareholders.* The benefited shareholders are deemed to issue financial instruments (the financing instruments) directly to the fast-pay shareholders in exchange for cash equal to the fair market value of the fast-pay stock at the time of issuance.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Summary of the Transaction's Tax Consequences

(ii) *Relationship between benefited shareholders and corporation.* The benefited shareholders contribute to the corporation ("Company") the cash they receive for issuing the financing instruments. Distributions made with respect to the fast-pay stock are distributions made by the corporation ("Compamy") with respect to the benefited shareholders' benefited stock. (iii) *Relationship between fast-pay shareholders and corporation.* For purposes of determining the relationship between the fast-pay shareholders and the corporation, the fast-pay stock is ignored. The corporation ("Company") is the paying agent of the benefited shareholders with respect to the financing instruments.

Link to Regulation §1.7701(1)-3

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/1-7701(l)-3.pdf

Rev. Rul. 2000-12 (Debt Straddles)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of Code and Reg. Sec.: §165 and §1275.

Summary of Transaction:

A taxpayer acquires two debt instruments that are structured so that the value of one will increase significantly at the same time that the value of the other one decreases by approximately the same amount. The taxpayer recognizes a current loss on the sale of the debt instrument that decreases in value while not recognizing the gain on the other debt instrument.

Shelter Transaction Result:

a. On sale of the debt instrument that decreases in value, the taxpayer claims a tax loss.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

a. The sale of debt instrument with a decreased value does not produce an allowable loss under § 165. When the taxpayer sells this debt instrument before its maturity date but retains the other debt instrument, the taxpayer does not realize an actual economic loss because the purported loss on the sale of decreased value debt instrument is substantially offset by the unrealized gain in the other debt instrument. Such an artificial loss is not allowable for federal income tax purposes. In each situation the taxpayer cannot recognize the claimed loss on the sale of the debt instrument that decreases in value while not recognizing the gain on the other debt instrument.

(Note: Other variations would disallow loss under Treas. Reg. § 1.1275-6(c)(2) (integrate to form synthetic debt instrument), or the anti-abuse rule of Treas. Reg. § 1.1275-2(g) applies.)

Link to Notice 2000-12

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Rev. Rul. 2000-12.pdf

Summary of the Transaction's Tax Consequences

This is a transaction based on IRC § 742.

Notice 2000-44 (Son of Boss)

Notice 2000-44, identifies a transaction, referred to as the "Son of BOSS". The Treasury news release stated that: "as in the BOSS Shelter, this new scheme uses a series of contrived steps (in this case involving interests in a partnership) to generate artificial tax losses designed to offset income from other transactions.

Summary of Transaction:

Notice 2000-44 describes a transaction in which a taxpayer subjects itself to a future economic obligation in exchange for cash. For example, taxpayer borrows cash or sells an option. Taxpayer then contributes the cash (or other property acquired with the cash) to a partnership in exchange for a partnership interest, plus the partnership's assumption of the obligation. The taxpayer claims a basis in its partnership interest equal to the cash or the adjusted basis of the property contributed to the partnership unaffected by the obligation assumed by the partnership.

Shelter Transaction Result:

On distribution of the partnership interest, the taxpayer claims a tax loss with respect to that basis amount, even though the taxpayer has incurred no corresponding economic loss.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that could may our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

a. The purported losses resulting from the transactions described above do not represent bona fide losses reflecting actual economic consequences as required for purposes of §165. (The purported losses from these transactions (and from any similar arrangements designed to produce non-economic tax losses by artificially overstating basis in partnership interests) are not allowable as deductions for federal income tax purposes),

b. The purported tax benefits from these transactions may also be subject to disallowance under other provisions of the Code and regulations such as §752, or under §1.701-2 or other anti-abuse rules. An example of a similar issue can be found in Salina Partnership v. Commissioner, T.C. Memo 2000-352

Link to Notice 2000-44:

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%2 02000-44.pdf

Link to Technical Advisor's Training Material:

http://lmsb.irs.gov/hq/pftg/p_ships/downloads/Training/partnership_atg.pdf

Notice 2000-60 (Stock Compensation Transaction)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC §§ 1032, 83(a), 331, 1001 and Treas. Reg. §1.83-6(d).

Summary of Transaction:

P contributes cash to S in exchange for S common stock. X contributes cash to S in exchange for S preferred stock. P and X's bases in their S stock equals the cash they contributed to S. S purchases stock from P's shareholders. From time to time, S transfers P shares to P employees in satisfaction of P's stock based-employee compensation obligations (e.g., upon the exercise by an employee of a non-statutory option to purchase P stock). In a few years, S will sell any remaining P stock, and then S will liquidate or P will sell its S stock.

Shelter Transaction Result:

a. When S transfers P stock to P employees, Treas. Reg. § 1.83-6(d) treats S, as a shareholder of P, as contributing the stock to P and P as using the stock to satisfy the obligation.

b. S' basis in the transferred stock shifts to the P stock S continues to hold.

c. Under, IRC § 1032, P reports no gain or loss from the deemed transfers of P stock to P employees;

d. P takes deductions under IRC § 83(h) in the amount that the P employees include in income under IRC § 83(a) from their receipt of the P stock.

e. When S liquidates or P sells its S stock, P claims a capital loss under IRC § 331 or IRC §1001.

f. S also reports a capital loss on the sale of its remaining P stock immediately before S' liquidation or sale.

Proper Tax Treatment:

a. Transfers by S to the P employees are properly characterized as distributions by S to P with respect to P's stock, subject to the rules of §301 and §311,

b. Compensatory transfers by P to P's employees are treated as distributions to the extent of earnings and profits and result in dividend treatment under §301(c)(1). To the extent that the amount of the distributions exceeds the earnings and profits of S, the distributions reduce P's basis in its S stock under §301(c)(2), thus reducing or eliminating P's purported loss with respect to the S stock upon S's liquidation or sale.

c. Because the transfers of P stock by S to P are distributions and not capital contributions, S is not permitted to shift basis from the transferred P stock to S's remaining P stock and, therefore, S does not have a capital loss on the sale of its remaining P stock immediately before S's liquidation or sale.

d. Alternatively, the steps can be ignored and the transaction can be treated as redemption by P of its stock followed by a compensatory transfer of treasury stock to its employees. No deduction is permitted for amounts paid to redeem stock, §162(k).

e. Losses claimed by P & S are considered not to be bona fide (i.e. lack economic substance), and can be disallowed under §165(a).

Link to Notice 2000-60

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 2000-60.pdf

Notice 2000-61 (Guam Trust)

Summary of the Transaction's Tax Consequences

Transactions claiming that IRC §641(b) applies to a trust as part of a scheme in which the trust seeks to be included under the single filling rules of IRC §935.

Summary of Transaction:

A trust is formed which purportedly meets (a) both U.S. and Guamanian statutory requirements for taxation as a resident, and (b) the IRC §1361(e) requirements for an electing small business trust (ESBT). Shares of a U.S. S corporation are then transferred to the trust. The trust files no income tax return in the United States, and under Guam law, the trust qualifies for a return of Guam taxes, provided 50 percent of the rebated taxes are kept on deposit in Guam for five years.

Shelter Transaction Result:

The shelter relies on a misinterpretation of the single filing rule of §935 to avoid filing a U.S. income tax return. A Guam return is filed, but the Guamanian taxes may be fully rebated. Therefore, according to the promoters, S corporation income flowing through such a trust would ultimately escape taxation in both the U.S. and Guam.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

The single filing rule contained in IRC §935 applies solely to individuals who are resident in Guam or citizens of Guam and are not otherwise citizens of the United States, individuals who are U.S. citizens or residents and have income derived from Guam, and individuals who file joint returns with any of these persons.

IRC §935 was enacted to permit such **individuals** to file a single income tax return, in Guam, thus eliminating the administrative burdens associated with the filing of two income tax returns. It was recognized that the foreign tax credit generally eliminated the tax liability to one of the jurisdictions, and therefore, that §935 generally would not affect the amount of tax ultimately due.

Nothing in the language of IRC §935, its legislative history, or the policy behind its enactment indicates that a trust is to be considered an individual for purposes of §935. The fact that under IRC §641(b) the taxable income of a trust is generally determined in the same manner as the taxable income of an individual has no bearing on whether a trust **is** an individual for purposes of IRC §935. Therefore, IRC §935 does not relieve a trust from any obligation it may have to file an income tax return for the taxable year with the United States and to pay to the United States any tax due.

Transactions in which it is claimed that §935 applies to a trust as part of a scheme in which the trust seeks effectively to avoid both U.S. and Guamanian tax liability may also be subject to challenge on other grounds.

Link to Notice 2000-61, 2000-49 I.R.B. 569

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 2000-61.pdf

Notice 2001-16 (Intermediary Transactions)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of Code and Reg. Sec.: §337, §1.337(d)-4 and §1001.

Summary of Transaction:

These transactions generally involve four parties: seller (X) who desires to sell stock of a corporation (T), an intermediary corporation (M), and buyer (Y) who desires to purchase the assets (and not the stock) of T. Pursuant to a plan, the parties undertake the following steps. X purports to sell the stock of T to M. T then purports to sell some or all of its assets to Y.

Shelter Transaction Result:

a. Y claims a basis in the T assets equal to Y's purchase price. Under one version of this transaction, T is included as a member of the affiliated group that includes M, which files a consolidated return, and the group reports losses (or credits) to offset the gain (or tax) resulting from T's sale of assets.

b. In another form of the transaction, M may be an entity that is not subject to tax, and M liquidates T (in a transaction that is not covered by § 337(b)(2) of the Internal Revenue Code or §1.337(d)-4 of the Income Tax Regulations, resulting in no reported gain on M's sale of T's assets.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Intermediary transactions do not produce the tax consequences claimed by the parties because, depending upon the facts of the specific transaction:

a. M is an agent for X, and consequently for tax purposes T has sold assets while T is still owned by X,

b. M is an agent for Y, and consequently for tax purposes Y has purchased the stock of T from X

c. The transaction is otherwise properly recharacterized (e.g., to treat X as having sold assets or to treat T as having sold assets while T is still owned by X);

d. Alternatively, the Service may examine M's consolidated group to determine whether it may properly offset losses (or credits) against the gain (or tax) from the sale of assets.

Link to Notice 2001-16

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 2001-16.pdf

Notice 2001-17 (Contingent Liability)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of Code and Reg. Sec.: §351, and § 357.

Summary of Transaction:

This transaction involves the transfer of a high basis asset to a corporation in exchange for stock of the transferee corporation, and the transferee corporation's assumption of a contingent liability (such as a liability for deferred compensation or other deferred employee benefits or an obligation for environmental remediation) that the transferor has not yet taken into account for Federal income tax purposes. The value of the stock of the transferee equals the value of the asset transferred reduced by the liability assumed by the transferee.

Shelter Transaction Result:

a. The transaction is intended to qualify as an exchange under IRC §351, with the intent that the basis of the stock that the transferor receives from the transferee corporation will be equal to the basis of the transferred asset, unreduced by the liability assumed by the transferee corporation.

b. The transferor typically sells the stock of the transferee corporation for its fair market value within a relatively short period of time after the purported IRC §351 exchange and claims a tax loss in an amount approximating the present value of the liability assumed by the transferee corporation.

c. Transferee corporation may claim a §162 deduction with respect to payments on the contingent liability as they become fixed.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

a. Disallow losses claimed by the transferor for transfers after October 18, 1999, by asserting that such losses are disallowed because the transferor's basis in the stock received is reduced under IRC §358(h) (reducing stock basis by the amount of certain liabilities).

b. For transfers on or before October 18, 1999, as well as for transfers after October 18, 1999 that are not subject to IRC §358(h), the Service will disallow such losses for one or more reasons, including but not limited to the following:

1) that the purported IRC §351 exchange lacks sufficient business purpose to qualify as an IRC §351 exchange;

2) that the transfer of the asset to the transferee corporation is not, in substance, a transfer of property in exchange for stock within the meaning of IRC §351, but instead is either an agency arrangement for the transferor or simply a payment to the transferee for its assumption of a liability;

3) that the purported IRC §351 exchange constitutes an acquisition of control of the transferee corporation for the principal purpose of tax avoidance within the meaning of IRC §269(a) and thus the purported loss should be disallowed under IRC §269(a);

4) that the principal purpose of the transferee's assumption of the liability was a purpose to avoid federal income tax or was not a bona fide business purpose within the meaning of IRC §357(b)(1), and thus the assumption of the liability should be treated as money received by the transferor that reduces its basis in the transferee stock;

5) that the purported loss on the sale of the stock of the transferee corporation is not a bona fide loss actually sustained by the transferor, as required by Treas. Reg. §1.165-1(b); and

6) that the overall transaction lacks sufficient economic substance to be respected for federal income tax purposes, see ACM Partnership v. Commissioner, 157 F.3d 231 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999).

a. In addition, any deduction claimed by a transferee corporation for payments on a liability assumed in a transaction similar to that described above may, depending on the facts of the particular case, be subject to disallowance on one or more of several possible grounds, including that the payments are not for ordinary and necessary business expenses of the transferee corporation. (Rev. Rul. 95-74, 1995-2 C.B. 36).

(7) that the liability is not within the scope of IRC §557 (c)(3) and IRC §358(d)(2) does not prevent the application of IRC §358(d)(1) to reduce basis by amount of the liability in the exchange.

Link to Notice 2001-17

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 2001-17.pdf

Notice 2001-45 (IRC §§302/318 basis shift)

This is a transaction based on the use of Code and Reg. Sec. §302, and §318.

Summary of Transaction:

A taxpayer acquires warrants in foreign corporation (FC). The warrants, if exercised, will give taxpayer a greater than 50 percent interest in FC. FC acquires a substantial amount of stock in a corporation at the same time the taxpayer acquires a de minimis amount of stock in the same corporation along with an option to acquire an additional amount of stock equivalent to the amount held by FC. The corporation redeems the stock held by the related party. Through the attribution rules of IRC §318, FC is not treated as suffering any equity reduction and so the redemption is taxed as a dividend to FC. Under Treas. Reg. §1.302-2(c), the basis in the stock previously held by the related party will now attach to the de minimis amount of shares held by the FC.

Shelter Transaction Result:

Due to the increase in basis of the stock, the taxpayer will be able to generate a substantial capital loss on a sale of the shares on the open market. The key to this shelter is minimizing the impact of the dividend income to the related party.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

The Service intends to disallow losses claimed (or to increase taxable income or gains) to the extent a taxpayer derives a tax benefit that is attributable to stock basis purportedly shifted from the redeemed shares. Reasons for disallowance may include, but are not limited to, the following: (1) the redemption does not result in a dividend (and consequently there is no basis shift) because, viewing the transaction as a whole, the redemption results in a reduction of interest in the redeeming corporation to which § 302(b) applies; (2) the basis shift is not a "proper adjustment" as contemplated by § 1.302-2(c); and (3) there is no attribution of stock ownership or basis shift because the steps taken to achieve those results are transitory and serve no purpose other than tax avoidance.

Link to Notice 2001-45

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/notice_2001-45.pdf

Additional Transactions

Since the publication of Notice 2001-51, the following additional abusive tax Shelter transactions have been identified as Listed Transactions.

Notice 2002-21 (Inflated Basis (CARDS))

This is a transaction based on the use of Code and Reg. Sec. §1012.

Summary of Transaction:

In general, the transaction involves the use of a loan assumption agreement to claim an inflated basis in assets acquired from another party. This inflated basis is claimed as a result of a U.S. taxpayer acquiring assets in exchange for becoming jointly and severally liable on indebtedness of the transferor of the assets (Transferor). Taxpayer agrees to pay the principal amount of the loan while transferor continues to make the interest payments. Thus the stated principal of the liability assumed by the taxpayer is substantially in excess of the fair market value of the assets transferred. Transferor may not be subject to U.S. tax or otherwise may be indifferent to the federal income tax consequences of the transaction.

Shelter Transaction Result:

Taxpayer claims that, as a result of its assumption of joint and several liability on the Loan, the entire principal amount of the Loan is included in Taxpayer's basis in the Conveyed Assets. As a result, Taxpayer claims a loss for federal income tax purposes in an amount equal to the excess of the stated principal amount of the Loan over the fair market value of the Conveyed Assets. If the Conveyed Assets are nonfunctional currency, Taxpayer claims an ordinary loss. This is often referred to as Synthetic Foreign Currency Zero-Coupon Borrowing. It is also referred to as Custom Adjustable Rate Debt (CARDS).

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

The notice states that the taxpayer's basis in the assets transferred is equal to the fair market value of such assets upon their acquisition by the taxpayer rather than the stated principal amount of the indebtedness. The purported tax benefits from these transactions are subject to challenge under provisions of the Code and regulations, including but not limited to § 988 and, in the case of individuals, IRC §§165(c)(2) 465. In the case of a corporation filing a consolidated return, Treas. Reg. § 1.1502-45 may be considered.

Link to Notice 2002-21

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%2 02002-21-CARDS.pdf

Rev. Rul. 2002-46 Deferred Contribution Plan

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of the Code and Reg. Sec: §§ 401(k) and 401(m)

Summary of Transaction:

These are transactions in which taxpayers claim deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by the plan participants after the end of the taxable year. It is substantially similar to the transaction described in Rev. Rul. 90-105, 1990-2 C.B. 69**.**

Shelter Transaction Result:

Deductions are claimed for the entire amount of elective and matching contributions to the Plan even though a portion of the deduction related to Post-Year End Contributions. Prior to the end of the taxable year, Taxpayer amended the plan and passed a board of directors' resolution setting forth a minimum contribution for the plan year that included the Post-Year End contributions. (The plan amendment and the board of directors' resolution are the only facts that distinguish this revenue ruling from 90-105.)

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

If the payment of the contributions is attributable to compensation earned after the end of the taxable year, under Reg. Sec. §1.404(a)-1(b), the Post Year End contributions could not be deductible. (Because of the plan amendment, they have met IRC §461(a), unlike in Rev. Rul. 90-105)

Link to Rev. Rul. 2002-46

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/rev_rul 2002-46 (L19) - IRS .pdf

NOTE: See Notice 2002-48 for certain variation to Rev. Rul. 90-105 that are not abusive.

Notice 2002-35 (Notional Principal Contract & Method of Accounting)

This is a transaction based on the misinterpretation of Code and Reg. §§ 446 and 1.446-3.

Summary of Transaction:

In general, the transaction involves the use of a Notional Principal Contract (NPC) to claim current deductions for periodic payments made by a taxpayer while disregarding the accrual of a right to receive offsetting payments in the future. The NPC has a term of more than one year, and the taxpayer is required to make periodic payments to the counter party (CP) at regular intervals of one year or less based on a fixed or floating rate index. In return, the CP is required to make a single payment at the end of the term of the NPC that consists of a noncontingent component and a contingent component. The noncontingent component may be based on a fixed or floating interest rate. The contingent component may reflect changes in the value of a stock index or currency.

Shelter Transaction Result:

The taxpayer deducts the ratable daily portion of each periodic payment for the tax year to which that portion relates. However, the taxpayer does not accrue income on the nonperiodic payment until the year the payment is received. The taxpayer intends to report as capital any gain realized on the termination of the NPC.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM 's, court cases, etc. that could change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

The notice states, that the requirement of § 1.446-3(f)(2)(i) that a nonperiodic payment must be recognized over the term of a NPC in a manner that reflects the economic substance of the contract must be applied separately to the noncontingent component of the contract, whether that component is based on a fixed or a floating interest rate.

In addition, depending on the facts of the particular case, the Service may challenge the purported tax results of these transactions on other grounds, including:

recharacterizing one or more of the transactions under §§ 1.446-3(g)(2) or 1.446- 3(i);

determining that the swap expense, if any, was not incurred in the course of a trade or business and was therefore subject to the 2-percent floor limitation in section 67 of the Internal Revenue Code;

disregarding the combination of the loans and the periodic payments as circular flows of cash;

or applying other variations of the doctrine of substance-overform.

Link to Notice 2002-35

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/notice%20 2002_35-Notional%20Prin%20Contracts.doc

Notice 2002-50, (Partnership Tax Straddle) IRB 1 (June 25, 2002)

This is a transaction based on the use of IRC §754.

Summary of Transaction

A Partnership Straddle Tax Shelter is a type of transaction used by taxpayers to generate tax deductions. The transaction was designed to use a straddle, a tiered partnership structure, a transitory partner, and the absence of a § 754 election to allow taxpayers to claim a permanent non-economic loss. The Service has determined in Notice 2002-50 that the tax benefits purportedly generated by these kinds of transactions are not allowable for federal income tax purposes. Notice 2002-50 also alerts taxpayers, their representatives, and promoters of these transactions of certain responsibilities that may arise from participating in these transactions.

The transaction involves the manipulation of partnerships through a series of steps to generate income tax deductions and is carried out in the following order. No IRC §754 election is in effect at any relevant time.

Step 1: Corporation acquires a majority interest in an upper tier partnership (UTP) at fair market value.

Step 2: UTP acquires a majority interest in a lower tier partnership (LTP) at fair market value.

Step 3: LTP enters into straddles on foreign currencies and may acquire other assets.

Step 4: LTP terminates the gain leg of a foreign currency straddle. LTP allocates a pro rata share of the gain to UTP, which in turn allocates a pro rata share of the gain to Corporation. This gain increases the basis of each partnership interest.

Step 5: Corporation sells its interest in UTP to Taxpayer at fair market value. This results in a loss to Corporation sufficient to offset the gain that was allocated to Corporation.

Step 6: Taxpayer purchases UTP's interest in LTP at fair market value. UTP realizes a loss on this sale, but the loss is disallowed under § 707(b)(1)(A) because Taxpayer owns more than 50% of UTP.

Step 7: LTP engages in a transaction that is intended to increase Taxpayer's basis in the LTP interest. For example, LTP may incur a liability that Taxpayer guarantees. LTP then terminates the loss leg of the foreign currency straddle and allocates a pro rata share of the loss to Taxpayer.

Step 8: Taxpayer sells the interest in LTP at its fair market value and realizes gain (for example, from the relief of liability). Taxpayer then claims that this gain is offset under § 267(d) by the amount of the loss that was disallowed to UTP under § 707(b)(1)(A).

Proper Tax Treatment

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM ,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

The Service intends to challenge the purported tax benefits from this transaction on a number of grounds:

First, the Service expects that the partnership anti-abuse rule contained in Treas. Reg. §1.701-2(b) will generally disallow the deduction claimed by the taxpayer upon the termination of the loss leg of the straddle. See Treas. Reg. § 1.701- 2(d) (Ex. 8) (disallowing duplication of a built-in loss deduction attributable to the absence of an IRC §754 election).

Second, the Service may challenge the allowance of the loss deduction based on other statutory provisions, including IRC § 988, and judicial doctrines, including the step transaction doctrine and the doctrines of economic substance, business purpose, and substance over form.

Third, the Service may assert that, where a loss is disallowed on the sale of a partnership interest under IRC §§ 267(a)(1) or 707(b)(1). IRC §267(d) must be applied under an aggregate approach rather than an entity approach. See Treas Reg. §1.701-2(e) (requiring aggregate treatment of partnerships for certain purposes). Because the gain realized by Taxpayer on the sale of its interest in LTP does not correspond to any increase in the value of the assets within LTP, the disallowed loss realized on the sale of LTP by UTP cannot be used to offset the gain under an aggregate approach.

Link to Notice 2002-50

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/notice 2002_50.pdf

I.D.3. Abusive Transactions Not Listed

Introduction

In addition to known abusive tax shelters identified as listed transactions, there is also a category of transactions that exhibit elements of abusive transactions, but have not officially been identified as listed transactions. As these transactions come to light, OTSA closely monitors them and studies their characteristics. If OTSA determines that any of these show potential for classification as a listed transaction, OTSA will forward them to Chief Counsel and Treasury for further consideration. Chief Counsel andTreasury makes the final determination regarding whether the transactions are sufficiently abusive to be elevated to the status of listed transactions. An example of a transaction exhibiting characteristics of an abusive tax shelter that has not been officially identified as a listed transaction is the Corporate Owned Life Insurance (COLI) transaction. The reason COLI is not officially classified as a listed transaction is that the issue was uncovered long before OTSA was established and before the Service started "listing" the abusive transactions. The Service, has, however, accorded COLI transactions the same treatment as the listed transactions.

COLI

In general, Corporate Owned Life Insurance (COLI) is a series of life insurance policies purchased by a corporation on the lives of some or all of its employees. The corporation, not the employee, is the beneficiary under these policies. The COLI issue addressed broad-based (i.e. large numbers of insured employees) highly leveraged COLI plans that exploit the tax arbitrage opportunities inherent in COLI policies. Through the use of large policy loans in the first three plan years, large interest deductions are generated from the policy loans beginning in year one. The tax benefits from these interest deductions, coupled with tax free mortality benefits, result in the COLI plans producing positive cash flows and earnings on an annual basis and over the life of the plans.

Because COLI plans are fueled by the predictable tax benefits gained through manufactured interest deductions, the annual cash flows and earnings are generally negative, absent the tax savings. Only on a post-tax basis do the cash flows and earnings become positive as a direct result of the tax savings generated by the interest deductions.

It is the Service's position that the transactions underlying the interest deductions are shams and therefore should not be respected for tax purposes. The Courts have uniformly sustained the Service's disallowance of COLI interest deductions, holding that the COLI policies lacked economic substance and therefore were economic shams. The Service has also successfully argued in litigation that the COLI plans violated the seven year level premium requirement of IRC § 264(d)(1).

(ALL REVENUE AGENTS WITH **COLI** TRANSACTIONS ARE REQUIRED TO CONTACT THE TECHNICAL ADVISOR GEORGE IMWALLE)

Case Law References

***Winn-Dixie Stores, Inc. v. Commissioner*,** 254 F.3d 1313 (11th Cir. 2001) *aff'g* 113 T.C. 254 (1999).

IRS v. C.M. Holdings, Inc., (in re CM Holdings, Inc.), 2002 U.S. App. LEXIS 17171 (3d Cir. 2002), aff'g . 254 B.R. 578, 2000-2 U.S. Tax Cas. (CCH) P50, 791 (D. Del2000).

American Electric Power v. United States, 136 F. Supp. 2d 762 (S.D. Ohio 2001).

Emerging Issues

As new emerging issues are detected, they will be posted on OTSA's intranet site.

Contact Technical Advisors and Division Counsel

The transaction summarized above is quite complex and may involve a multitude of legal issues, including the business purpose and economic substance doctrines. Issues involved in these doctrines require extensive time and knowledge for proper development. Therefore, when revenue agents suspect that they have found a tax shelter, they should contact the Technical Advisor assigned to that transaction for assistance. In addition, they should involve counsel early in the development process. Both of these resources will serve to reduce audit time and lead to a well-developed issue.

Part II - Judicial Doctrines Used to Combat Abusive Tax Shelters

II.A. Introduction

Introduction

The IRS has two primary means to deny the tax benefits of tax shelters.

First, the IRS may argue that the objective facts of the transaction are not as the taxpayer has presented them. That is, the formal way in which the taxpayer has presented the facts belies their real substance and, as a result, the taxpayer is applying the wrong set of mechanical rules in reaching its purported tax consequences.

Second, the IRS may argue that while the facts are as the taxpayer has represented, the technical tax results produced by a literal application of the law to those facts are unreasonable and unwarranted, and therefore should not be respected. This second line of argument which encompasses long standing principles of business purpose and economic substance, is an important and essential gloss on our generally mechanical system of determining tax liabilities. Application of these doctrines to a particular set of facts is often uncertain. Typically, in the cases in which the IRS has been successful, the IRS has argued that the taxpayer's transaction was in some sense artificial, that the taxpayer undertook the transaction in a particular way (even though economically equivalent avenues were available to the taxpayer) to achieve an unreasonable or unwarranted tax benefit. Often, it is clear that if tax savings had not been an issue, the taxpayer would have used a more straight-forward (and more heavily-taxed) route.

Joint Committee on Taxation

The Joint Committee on Taxation (JCT) prepared a study on corporate tax shelters in 1999 that provides an excellent overview of the judicial doctrines used to combat abusive tax shelters. These doctrines are key components in most tax shelters.

Judicial Doctrines

The judicial doctrines which the courts have created, developed and re-interpreted to address unreasonable or unwarranted tax benefits include:

 substance-over-form,

 step transaction doctrine,

 economic substance,

 sham transaction, and

 business purpose.

The JCT's Study on tax shelters, *JCX-84-99*, will be used to discuss these doctrines in the next section, and the cases these doctrines are based on will be discussed in the second section.[1]

II.B. Judicial Doctrines Used to Combat ATS

Introduction

There are five judicial doctrines used to deny benefits to tax shelters. The following section outlines the *JCX-84-99* discussion of these doctrines.

1. Sham Transaction Doctrine

Sham transactions are those in which the economic activity that is purported to give rise to the desired tax benefits does not actually occur. The transactions have been referred to as "facades" or mere "fictions"[20] and in their most egregious form; one may question whether the transactions might be characterized as fraudulent.

At a minimum, the sham transaction doctrine can be said to apply to a "sham in fact." For example, where a taxpayer purported to buy treasury notes for a small down payment and a financing secured by the treasury notes in order to generate favorable tax benefits, but neither the purchase nor the loan actually occurred, the court applied the sham transaction doctrine to deny the tax benefits.[21]

Generally, the sham transaction doctrine applies when the purported activity giving rise to the tax benefits does not actually occur. However, in certain circumstances, a transaction may be found to constitute a sham even when the purported activity does occur. For example, taxpayer enters into a transaction to generate a loss. The taxpayer actually has risk with respect to the transaction, but transfers that risk to a broker through a guarantee. The only consequences to the taxpayer will be the desired tax benefits. This transaction may be found to be "in substance" a sham.[22] Finally, as discussed above, the delineation between this doctrine (particularly as applied to shams "in substance") and the "economic substance" and the "business purpose" doctrines (both discussed below) is not always clear. Some courts find that if transactions lack economic substance and business purpose, they are "shams" notwithstanding that the purported activity did actually occur.[23]

2. Economic Substance Doctrine

To be respected, a transaction must have economic substance separate and distinct from the economic benefit achieved solely by tax reduction.

Under the economic substance doctrine, the courts generally will deny claimed tax benefits where the transaction giving rise to those benefits lacks economic substance independent of tax considerations. The Tax Court recently described the doctrine as follows:

> The tax law ... requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction. The doctrine of economic substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings.[24]

The seminal authority most often credited for laying the foundation of the economic substance doctrine is the Supreme Court and Second Circuit decisions in *Gregory v. Helvering.*[25]

In *Gregory*, a transitory subsidiary was established to utilize the corporate reorganization provisions of the Code, to take advantage of a tax advantaged distribution from a corporation to its shareholder of appreciated corporate securities that the corporation (and its shareholder) intended to sell. Although the court found that the transaction satisfied the literal definition of a tax-free reorganization, the Second Circuit held (and the Supreme Court affirmed) that satisfying the literal definition was not enough:

> To dodge the shareholder's taxes is not one of the transactions contemplated as corporate reorganizations.[26]

Since *Gregory*, several cases have denied tax benefits on the grounds that the subject transactions lacked economic substance.[27] The economic substance doctrine can apply even when a taxpayer exposes itself to risk of loss and where there is some profit potential (i.e., where the transactions are real) if the facts suggest that the economic risks and profit potential were insignificant when compared to the tax benefits.[28] In other words, the doctrine suggests a balancing of the risks and profit potential as compared to the tax benefits in order to determine whether the transactions had "purpose, substance or utility apart from their anticipated tax consequences."[29]

3. Business Purpose Doctrine

Another doctrine that overlays and is often considered together with (if not part and parcel of) the sham transaction and economic substance doctrines is the business purpose doctrine. Although numerous authorities apply the business purpose doctrine in the context of individuals or partnerships, the doctrine equally applies in the corporate context. Additionally, the business purpose doctrine is not limited to cases where the relevant statutory provisions by their terms require a business purpose or profit potential.[62]

In its common application, the courts use business purpose (in combination with economic substance, as discussed above) as part of a two-prong test for determining whether a transaction should be disregarded for tax purposes: (1) the taxpayer was motivated by no business purpose other than obtaining tax benefits in entering the transaction, and (2) the transaction lacks economic substance.[63] In essence, a transaction will only be respected for tax purposes if it has "economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached."[64]

The business purpose test is a subjective inquiry into the motives of the taxpayer, that is, whether the taxpayer intended the transaction to serve some useful nontax purpose.[65] Finally, where appropriate, the court may bifurcate a transaction in which independent activities with nontax objectives have been combined with an unrelated transaction having only tax-avoidance objectives in order to establish a business purpose for the overall transaction.[66] Thus, a taxpayer cannot utilize an unrelated business objective to hide the lack of business purpose with respect to the particular tax-motivated activity.

4. Substance Over Form Doctrine

The concept of the substance over form doctrine is that the tax results of an arrangement are better determined based on the underlying substance rather than an evaluation of the mere formal steps by which the arrangement was undertaken. For instance, two transactions that achieve the same underlying result should not be taxed differently simply because they are achieved through different legal steps. The Supreme Court has found that a "given result at the end of a straight path is not made a different result because reached by following a devious path."[67] However, many areas of income tax law are very formalistic and, therefore, it is often difficult for taxpayers and the court to determine whether application of the doctrine is appropriate.

While tax cases have been decided both ways, the IRS generally has the ability to recharacterize a transaction according to its underlying substance. Taxpayers, however, are usually bound to abide by their chosen legal form.[68] In National Alfalfa Dehydrating & Mill & Co., the Supreme Court ruled as follows:

> This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, [citations omitted], and may not enjoy the benefit of some other route he might have chosen to follow but did not.[69]

The IRS has published administrative guidance that applies the substance over form doctrine in a variety of contexts.[70] Taxpayers and tax practitioners apply these pronouncements, as well as certain favorable court cases, as an exception to the general rule that taxpayers are bound by their chosen form.

5. Step Transaction Doctrine

An extension of the substance over form doctrine is the step transaction doctrine. The step transaction doctrine "treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result."[71] The courts have generally developed three methods of testing whether to invoke the step transaction doctrine: (1) the end result test, (2) the interdependence test, and (3) the binding commitment test. The end result test is the broadest of the three articulations.

The end result test examines whether it is apparent that each of a series of steps are undertaken for the purpose of achieving the ultimate result.[72] The interdependence test attempts to prove that each of the steps were so interdependent that the completion of an individual step would have been meaningless without the completion of the remaining steps. The binding commitment test is the narrowest of the three articulations and looks to whether, at the time the first step is entered into, there is a legally binding commitment to complete the remaining steps.[73]

In determining whether to invoke the step transaction doctrine, the courts have looked to two primary factors: (1) the intent of the taxpayer,[74] and (2) the temporal proximity of the separate steps. If a taxpayer can provide evidence that at the time the first of a series of steps was undertaken, there was no plan or intention to affect the other steps, then the transactions should not be stepped together. An important factor that supports a taxpayer's lack of intent is found where subsequent steps are prompted by external, unexpected events that are beyond the taxpayer's control. Where there is no legally binding commitment to engage in subsequent steps after undertaking the initial transaction, the span of time between the events is an important measure in determining whether the transactions should be stepped together. A significant lapse of time between a series of transactions should prevent the application of the step transaction doctrine.[75]

The step transaction doctrine may not be invoked in all cases, irrespective of the taxpayer's intent or the temporal relationship of the separate steps.

Aside from a case involving a legally binding agreement,[76] if each of a series of steps has independent economic significance, the transactions should not be stepped together.[77] Also, the courts have not permitted the application of the step transaction doctrine if its application would create steps that never actually occurred.[78] This limitation is sometimes viewed as prohibiting the use of the step transaction doctrine where the alternative transaction has at least the same number of steps.[79] Another possible limiting factor to the application of the step transaction doctrine is when the steps in a series of transactions are separated by a real and meaningful shareholder vote to continue with the subsequent steps. While such a shareholder vote may be an indication of separate, unrelated steps, particularly when the corporation is publicly traded, it is not determinative. Finally, as discussed above, the IRS and not the taxpayer generally has the ability to recharacterize a series of transactions under the step transaction doctrine.

The review of the case law associated with these doctrines follow in the next section.

II.C. Case Analysis

Cases

Introduction

This section provides a brief overview of several abusive tax shelter court cases.

Economic Substance Doctrine - Gregory v. Helvering

Gregory v. Helvering is the case most often cited as the source of the economic substance doctrine. *See Gregory v. Helvering*, 293 U.S. 465 (1935) (addressing the question of whether a tax-free reorganization took place where the taxpayer had no intent to carry on the existing corporate business, only a desire to minimize taxes). In this case, Gregory (the taxpayer) wished to transfer stock from a corporation she wholly owned to herself. Had she done so directly, the transfer would have been treated as a taxable dividend. Instead, in an attempt to avoid taxation, Gregory formed a new corporation, transferred the stock there, liquidated the newly formed corporation, and claimed its assets. She argued that, pursuant to section 112(g) of the Revenue Act of 1928, 45 Stat. 791, 818, this transaction should have no tax consequences because she had received the stock "in pursuance of a plan of [corporate] reorganization." *Gregory,* 293 U.S. at 468. Although the transaction satisfied the literal terms of the statute, the Court sided with the Commissioner, condemning the transaction as an "elaborate and devious form of conveyance masquerading as a corporate reorganization." *Id.,* at 470. The Court determined that to allow Gregory to avoid taxation would be to "exalt artifice above reality and to deprive the statutory provision in question of all serious purpose" *Id.,* at 470. Numerous courts have since cited this case for the general principle that a transaction that lacks substance is not recognized for Federal tax purposes.

The Merrill Lynch Installment Sale Partnership Transactions

A Merrill Lynch & Co., Inc. ("Merrill Lynch") investment plan is the subject of three cases:

1. ACM Partnership v. Commissioner, T.C. Memo 1997-115, aff'd in part and rev'd in part, 157 F.3d 231 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999)

2. ASA Investerings Partnership v. Commissioner, T.C. Memo 1998- 305, aff'd 201 F.3d 505 (D.C. Cir. 2000), cert. denied 531 U.S. 871 (2000)

3. SABA Partnership v. Commissioner, T.C. Memo 1999-359, vacated and remanded, 273 F.3d 1135 (D.C. Cir. 2001).

These cases center on an investment plan that Merrill Lynch had marketed to large U.S. companies. The plan's principal aim was to generate huge capital losses which would then offset existing (or expected) capital gains. At the outset, the plan required that the U.S. company form a partnership (based outside the United States) with a foreign entity that paid no U.S. income tax. This foreign entity would maintain an overwhelming majority partnership interest. By implementing a number of steps and by relying on the installment sale and contingency sale rules, the plan was able to generate huge capital losses. The Merrill Lynch plan generally involved the following seven steps:

1. The U.S. company would enter into a foreign-based partnership with a foreign entity that was not subject to U.S. income tax.

2. The foreign entity would have the overwhelming majority partnership interest while the U.S. company would own a distinct minority interest.

3. The partnership would purchase short-term private placement notes ("PPNs") eligible for the installment method of accounting. It then would sell them for a large cash down payment with the balance made up of a comparatively small amount of debt instruments (five-year Libor notes) whose yield over a fixed period of time was not ascertainable. One-sixth of the basis would be applied to the down payment. The gain from the down payment would be allocated according to the partnership interests. Therefore, the foreign partner would receive the majority of the gain.

4. The partnership would claim a large basis (five-sixths of the basis of the PPNs) in the Libor notes.

5. After the close of the first tax year, the partnership interests would become substantially reversed. (The U.S. Company would acquire a majority interest by purchasing part of the foreign entity's interest.)

6. The partnership would distribute cash to the foreign entity and the Libor notes to the U.S. partner in partial redemption of their partnership interests.

7. The U.S. company then would sell the Libor notes to a third party, accelerating the loss. Since the basis of the instruments would greatly exceed their value, the sale would result in a large "paper" loss the U.S. Company

would use to offset existing capital gains.[1]

ACM Partnership

The Third Circuit Court of Appeals generally affirmed the Tax Court's decision in *ACM Partnership v. Commissioner*, whereby the lower court held that the economic substance doctrine precluded the partnership's deduction of approximately $85 million of losses attributed to the purchase and contingent installment sale of certain notes. *ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998), *aff'g,* T.C. Memo 1997-115.

Under the facts of this case, Colgate-Palmolive (the taxpayer) aimed to offset the tax effects of a 1988 multimillion dollar capital gain. In 1989, ABN (a major Dutch bank and the foreign entity involved in all three Merrill Lynch plan cases), Colgate-Palmolive, and Merrill Lynch each created a new company (referred to here as A, C and M, respectively). These three companies then formed the ACM partnership to generate capital losses Colgate-Palmolive could use to offset some of its 1988 capital gains. The partnership was capitalized with $205 million - A held 82.6 percent, C held 17.1 percent, and M held 0.3 percent. ACM used an elaborate series of securities transactions that ultimately resulted in its selling $175 million in PPNs for $140 million in cash and eight Libor notes with a present value of approximately $35 million. Since the total amount was based on a contingency (due to fluctuations in the Libor), ACM treated the transaction as an installment sale, allowing it to "recover" one-sixth of the basis each year over the term of the contract.

The $140 million ACM collected in the year of sale resulted in a $110.7 million gain, which was allocated primarily to partner A. After the close of the first tax year, Colgate-Palmolive purchased part of A's partnership interest. ACM redeemed a portion, leaving Colgate-Palmolive as the majority partner. Subsequent installment payments resulted in capital losses allocated primarily (99.7 percent) to Colgate-Palmolive. In December 1991, the partnership sold the Libor notes, accelerating the remaining loss. Colgate-Palmolive reported total capital losses of more than $98 million over the course of its participation in ACM. It then carried these losses back to offset its 1988 capital gain.

In 1993, the Service challenged ACM's treatment of the transaction and disallowed the use of the installment sale rules, calling it a sham transaction creating "phantom" losses.

The Tax Court found that the taxpayer desired to take advantage of a loss that was not economically inherent in the object of the sale, but which the taxpayer created artificially through the manipulation and abuse of the tax laws. *ACM Partnership v. Commissioner,* T.C. Memo 1997-115. The Court added that the tax law requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction. It held that the transactions lacked economic substance and, therefore, the taxpayer was not entitled to the claimed deductions. *ACM Partnership,* T.C. Memo 1997-115. Thereafter, ACM appealed to the Third Circuit Court of Appeals.

On appeal, the Third Circuit Court of Appeals relied on *Gregory* in applying the substance-over-form doctrine and the business purpose test. *ACM Partnership v. Commissioner,* 157 F.3d 231 (3d Cir. 1998). The Court viewed the transactions as a whole, as well as each step from beginning to end, to determine if they had sufficient economic substance to be respected for tax purposes. Ultimately, the court found ACM's transactions had only nominal, incidental effects on the partnership's net economic position. The court emphasized, "Gregory requires us to determine the tax consequences of a series of transactions based on what actually occurred," and it affirmed the Tax Court decision that ACM's transactions lacked economic substance. *ACM Partnership,* 157 F.3d at 250.

ASA Investerings Partnership

In *ASA Investerings Partnership,* involving a similar transaction to that of *ACM Partnership*, the Tax Court focused on the validity of the partnership. *ASA Investerings Partnership v. Commissioner,* T.C. Memo 1998-305. In this case, AlliedSignal used the Merrill Lynch plan to generate losses to offset a 1990 $400 million capital gain. AlliedSignal and its new wholly owned subsidiary ASIC entered into a partnership with two Netherlands

Antilles special purpose corporations (which ABN controlled). In April 1990, the partnership bought $850 million in PPNs. One month later, it sold the PPNs for $681.3 million and 11 Libor notes; the total value was approximately $850 million. The partnership reported a $539,443,361 gain on its partnership return, allocated according to the partnership interests--$485 million to the foreign entities and $53 million to AlliedSignal and ASIC. The foreign entities paid no U.S. income tax. After the close of the first tax year, AlliedSignal acquired a majority partnership interest by purchasing part of the foreign entities' interest.

In August 1990, ASA distributed the Libor notes to AlliedSignal and ASIC in partial redemption of their partnership interest and cash and commercial paper to the foreign entities. The Libor notes carried an adjusted basis of $709 million (five-sixths of the basis of the PPNs). Allied sold some of the Libor notes in 1990 and the remainder in 1992, claiming a total loss of $ 538 million. It used the losses to offset the gain from the sale of its interest in another company. Although AlliedSignal reported a tax loss of $538 million, its actual economic profit was about $3.6 million.

The Service audited the partnership returns for 1990 through 1992, determining that ASA was not a valid partnership and adjusted the returns to allocate all gains and losses to AlliedSignal. The Tax Court focused on the purported business purpose of AlliedSignal and ABN . Allied entered into the venture for the sole purpose of generating capital losses, and ABN entered into it solely to receive its expected return. Allied bore all the expenses, and ABN did not intend to, nor did it actually, share in ASA's losses. The Tax Court concluded the relationship between the two was merely a contractual, debtor-creditor relationship--not a partnership.

The Tax Court's opinion was affirmed by the Court of Appeals for the District of Columbia. *ASA Investerings Partnership v. Commissioner*, 201 F.3d 505 (D.C. Cir. 2000). Although the appellate court wrote that parties with different business goals are not precluded from having the intent required to form a partnership, the court affirmed the Tax Court's holding that the arrangement between the parties was not a valid partnership, in part because "[a] partner whose risks are all insured at the expense of another partner hardly fits within the traditional notion of partnership." *Id.* at 515. The appellate court rejected the taxpayer's argument that the test for whether a partnership is valid differs from the test for whether a transaction's form should be respected, writing that "whether the 'sham' be in the entity or the transaction ... the absence of a nontax business purpose is fatal." *Id.* at 512.

SABA Partnership

A third Merrill Lynch installment sale case involved Brunswick Corp.'s ("Brunswick") decision to divest some of its businesses. *SABA Partnership v. Commissioner,* T.C. Memo 1999-359. The company expected a $125 million gain and met with Merrill Lynch to get help minimizing the tax impact.

Merrill Lynch proposed a transaction involving the creation of two partnerships (SABA and Otrabanda) to generate capital losses to offset the gains. Brunswick and a foreign bank formed these two partnerships, with PPNs and certificates of deposit (CDs). Within a month the partnerships sold the PPNs and CDs for cash and LIBOR notes in transactions structured to satisfy the requirements of contingent installment sales. Due to the partnerships' capital contributions, 90 percent of the gains were allocated to the foreign bank, which was not subject to U.S. income tax. After the partnerships' tax year, the bank's partnership interests were reduced through direct purchases by Brunswick and redemptions by the partnerships. The partnerships distributed cash to the bank and the LIBOR notes to Brunswick, which sold the notes for cash. Brunswick reported capital losses of $175 million on its 1990-1991 tax returns. Brunswick argued that an economic substance analysis wasn't warranted and that it should be required to show only that the transactions resulted in contingent sales of the PPNs/CDs under IRC §§ 1001(a) and 453(a).

The Tax Court revisited *Gregory* and applied the principle that although a business transaction may be structured in strict compliance with the law, a court is not obliged to respect its form when the record shows the transaction was contrived to obtain a tax benefit Congress did not intend. The partnerships had been organized to generate losses for Brunswick. The transactions did not change the company's economic position, and they lacked economic substance. Therefore, the company should not recognize any gains or losses on the sales of the PPNs or CDs. The Court rejected the argument that the transaction had a non-tax business purpose. *Saba Partnership v. Commissioner*, T.C. Memo 1999-359.

The D.C. Circuit Court vacated and remanded the case to the Tax Court, in light of its recent decision in *ASA Investerings Partnership v. Commissioner. Saba Partnership v. Commissioner*, 273 F.3d 1135 (D.C. Cir. 2001). The Court dismissed the argument that the transactions had economic substance and concluded that the *ASA Investerings Partnership* case made it clear that the absence of a non-tax business purpose was fatal to the argument that the Service should respect an entity for tax purposes. Refusing to affirm on the basis of *ASA Investerings Partnership*, the court noted that the record strongly suggested that the partnerships were sham partnerships organized to generate tax losses for Brunswick, and fairness dictated that the court ought not to affirm on this ground. *Saba Partnership*, 273 F.3d at 1141.

The Tax Court revisited *Gregory* and applied the principle that although a business transaction may be structured in strict compliance with the law, a court is not obliged to respect its form when the record shows the transaction was contrived to obtain a tax benefit Congress did not intend. The partnerships had been organized to generate losses for Brunswick. The transactions did not change the company's economic position, and they lacked economic substance. Therefore, the company should not recognize any gains or losses on the sales of the PPNs or CDs. The Court rejected the argument that the transaction had a non-tax business purpose. *Saba Partnership v. Commissioner*, T.C. Memo 1999-359.

COLI Cases

A number of recent court opinions have addressed whether certain broadbased company-owned-life-insurance ("COLI") transactions had sufficient economic substance and business purpose to permit the owners of the underlying policies to deduct interest incurred on policy loans under IRC § 163. In each case, the court concluded that the COLI plans at issue lacked economic substance and business purpose.

Winn-Dixie

The first of these cases originated in the Tax Court in 1999. *See Winn-Dixie Stores, Inc. ("Winn-Dixie") v. Commissioner,* 113 T.C. 254 (1999), *aff'd per curiam,* 254 F.3d 1313 (11th Cir. 2001), *cert. denied,* 122 S.Ct. 1537 (2002). In 1993, the Winn-Dixie (the taxpayer) purchased a COLI plan whose sole purpose, as shown by contemporary memoranda, was to satisfy Winn-Dixie's "appetite" for interest deductions. Under the program, Winn-Dixie purchased whole life insurance policies on almost all of its full-time employees, who numbered about 36,000. Winn-Dixie was the sole beneficiary of the policies, and it was able to borrow against the policies' account value at an interest rate of over 11.06 percent Under the program, the insurer provided Winn-Dixie with a loaned crediting rate of 10.66 percent on leveraged cash values, thereby producing a fixed spread of 40 basis points. In contrast, the insurer provided Winn-Dixie with a crediting rate of 4 percent on unborrowed cash values.

The promoters of the COLI plan in Winn-Dixie provided the taxpayer with detailed projections of costs and benefits expected from the plan over a 60- year period. Particularly, the projections indicated that, during each policy year, the plan would generate a pre-tax loss and a significant after-tax profit, attributable to deductions for policy loan interest and administrative fees. The plan contemplated that the taxpayer would maintain little net equity in the policies, relative to the size of the plan.

In essence, the high interest and the administrative fees that came with the program outweighed the net cash surrender value and benefits paid on the policies, with the result that in pretax terms Winn-Dixie lost money on the program. The deductibility of the interest and fees post-tax, however, yielded a benefit projected to reach into the billions of dollars over 60 years. Winn-Dixie participated until 1997, when a change in tax law jeopardized this tax arbitrage.

The Service determined a deficiency because of the interest and fee deductions taken in Winn-Dixie's 1993 tax year. Winn-Dixie challenged the determination before the Tax Court. The Tax Court first addressed whether the COLI plan possessed sufficient objective economic substance. The Court found that the taxpayer did not purchase the plan to provide death benefit protection, noting the large number of geographically dispersed insured and the fact that the employees remained insured even after their employment was terminated. *Winn-Dixie,* 113 T.C. at 284-85. The Court further observed that, although there would be some variation between the anticipated and actual mortality of the 36,000 insured, such variations were not expected to significantly affect the plan. Viewing the COLI plan as a whole, and noting the annual discrepancy between pre-tax losses and after-tax profits set forth in the promotional material, the court found that the plan's only function was to reduce the taxpayer's income tax liability. *Id.* at 285. Thus, the Court concluded the plan lacked economic substance.

The Tax Court next addressed whether the taxpayer had a sufficient subjective business purpose for entering into the COLI transaction. The Court rejected the taxpayer's argument that its business purpose for entering into the transaction was to generate funds to pay for the increasing cost of its employee benefits program, which included limited death benefits. The Court further explained that there was no indication that the COLI policies were tailored to fund the taxpayer's employee benefit plan, and that employees remained insured after they left the taxpayer's employ. *Id.* at 286. In addition, the Court explained that even if the taxpayer had earmarked the COLI plan's tax savings to fund its employee benefits, that would not be sufficient to "breathe substance" into the transaction. Otherwise, reasoned the court, "every sham tax shelter device might succeed." *Id.* at 287. Moreover, the Court noted that the taxpayer was offered an "exit strategy" to terminate the plan if new legal limitations were imposed upon taxpayer's interest deductions, thereby suggesting that the purported business purpose for the plan was not sufficient to maintain the plan without the plan's tax benefits. *Id.* at 288-89. Thus, the Court concluded that the COLI plan served no business purpose for the taxpayer, other than to reduce its taxes.

The taxpayer in *Winn-Dixie* appealed to the Eleventh Circuit Court of Appeals, which affirmed the Tax Court's decision per curiam; and, the Supreme Court recently denied its petition for writ of certiorari. *Winn-Dixie Stores, Inc. v. Commissioner,* 113 T.C. 254 (1999), *aff'd per curiam,* 254 F.3d 1313 (11th Cir. 2001), *cert. denied,* 122 S.Ct. 1537 (2002).

C.M. Holdings, Inc. and American Electric Power, Inc.

The next opinions to address broad-based COLI transactions are *I.R.S. v. C.M. Holdings, Inc. ("C.M. Holdings")*, 254 B.R. 578 (D. Del. 2000), aff'd 2002 U.S. App. LEXIS 17171 (3rd Cir. 2002), and *American Electric Power, Inc. v. United States ("A.E.P."),* 136 F. Supp.2d 762 (S.D. Ohio 2001), which involved similar COLI transactions based upon policies issued by the same insurer. In *C.M. Holdings* and *A.E.P.*, the taxpayers purchased COLI plans comprised of 1,430 and approximately 20,000 policies, respectively. The COLI plans in *C.M. Holdings* and *A.E.P.*, in similar fashion to the COLI plan in Winn-Dixie. contemplated a scheme whereby the taxpayers would systematically borrow from the policies to pay premiums. The taxpayers in *C.M. Holdings* and *A.E.P.*, before purchasing the COLI plans, received financial illustrations indicating that the COLI plans would generate annual pre-tax losses and significant after-tax profits, primarily attributable to deductions for policy loan interest. The courts in both cases described the features of the plans as follows: (1) high policy value on the first day of the policy; (2) maximum policy loans used to pay high premiums during the first three policy years; (3) zero net equity and maximum borrowing at the end of each policy year, perfected through the use of computer programs; (4) a variable interest rate provision whereby the taxpayer could choose the interest rate that it paid on policy loans; (5) a fixed spread between the policy loan rate and the loaned crediting rate, "with the counterintuitive result" that the higher the loan interest rate paid by the taxpayer, the greater the cash flow due to increased tax deductions; and (6) extremely high expense load components for the fourth through seventh policy years, which were used to create policyholder dividends that could be used to pay premiums. *A.E.P.,* 136 F.Supp at 777-78; *C.M. Holdings,* 254 B.R. at 596-97.

In addressing whether the COLI plans at issue lacked objective economic substance, the courts in *C.M. Holdings* and *A.E.P.* compared the plans' economic effects on a pre-tax and after-tax basis. The courts first noted that, according to the financial illustrations provided to the taxpayers before they purchased the COLI plans, the plans were projected to generate negative pretax cash flows and positive after-tax cash flows over the life of the plans. *A.E.P.,* 136 F.Supp at 787-88; *C.M. Holdings,* 254 B.R. at 631-32. The courts further explained that the taxpayers did not expect to derive material economic gain from the non-tax beneficial components of the COLI plans, i.e., tax deferred inside build-up and tax-free death benefits. *A.E.P.,* 136 F.Supp at 787-88; *C.M. Holdings,* 254 B.R. at 631-32. In addition to addressing whether the taxpayer sought to generate inside build-up and receive death benefits in excess of cost, the *A.E.P.* court expressed particular concern that the parties, in designing the policies' interest rate provisions, exploited a loophole in the NAIC model bill, in an attempt to ensure that the taxpayer would always pay a policy loan interest rate in excess of the Moody's Corporate Average Rate. *A.E.P.,* 136 F.Supp at 789-790. Thus, the courts in *C.M. Holdings* and *A.E.P.* concluded that the COLI plans lacked economic substance.

In addition to the economic substance argument, the *C.M. Holdings* and *A.E.P.* courts addressed the parties' subjective business purpose for entering into the COLI transactions. The taxpayer in *C.M. Holdings* argued that it entered into the COLI transaction for the legitimate purpose of providing for the increasing cost of its employees' medical benefits, whereas the taxpayer in *A.E.P*. argued that it entered into the COLI transaction for the legitimate purpose of offsetting the cost of implementing FAS 106. Both courts rejected the taxpayers' arguments, emphasizing that the business purpose test is whether the underlying transaction has a legitimate purpose, not whether the taxpayer has a legitimate use for the after-tax cash flows generated by the transaction. *A.E.P.,* 136 F.Supp at 791-92; *C.M. Holdings,* 254 B.R. at 638. The Court in C.M. Holdings particularly noted the taxpayer's concern with pending tax legislation, manifested by a "honeymoon letter" and an attempt to execute the transaction before Congressional hearings on COLI began, as further indication that the COLI plan's critical feature was its ability to generate interest deductions. *C.M. Holdings,* 254 B.R. at 640. Thus, finding that the earnings generated by the COLI plans were tax-driven, the courts concluded that the plans served no legitimate business purpose.

The Third Circuit sustained the district court's determination in CM Holdings, agreeing that the COLI program was a sham for tax purposes. Although not impacting on the disallowance of the $13.8 million in interest deductions, the Circuit Court held that the loading dividends were not factual shams, since the transactions actually occurred, but that the fact that the dividends are not industry practice was evidence of a sham. The court also affirmed the imposition of the penalties for substantial understatement. *IRS v. CM Holdings, Inc. (In re CM Holdings, Inc.)*, 2002 U.S. App. LEXIS 17171 (3d Cir. 2002).

Rice's Toyota World

In *Rice's Toyota World, Inc. v. Commissioner ("Rice's Toyota World"),* 752 F.2d 89, 91-92 (4th Cir. 1985), *aff'g* 81 T.C. 184 (1983), the taxpayer purchased a used computer from the seller, gave the seller a recourse note and two non-recourse notes on the computer, and leased the computer back to the seller. The taxpayer paid off the recourse note and claimed depreciation deductions based on ownership and interest deductions for payments on the note. The Service disallowed all depreciation deductions and interest expense deductions based on the recourse and non-recourse notes. The Tax Court upheld the disallowance, explaining that "the transaction was not motivated by a business purpose, was devoid of economic substance, and should be disregarded for Federal income tax purposes." *Rice's Toyota World,* 81 T.C. at 210.

The Fourth Circuit affirmed the finding of a sham transaction and disallowance of depreciation deductions based upon inclusion of the nonrecourse and recourse note and interest deductions from non-recourse debt. The appellate court reversed the disallowance of interest deductions arising out of recourse debt, holding that transactions with economic substance could not be ignored, even if motivated by tax avoidance. *Rice's Toyota World,* 752 F.2d at 96.

Specifically, the Fourth Circuit held that it is appropriate for a court to engage in a two-part inquiry to determine whether a transaction has economic substance or is a sham that should not be recognized for income tax purposes. To treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and that the transaction has no economic substance because no reasonable possibility of a profit exists. *Id.* at 91.

UPS

United Parcel Service of America, Inc. v. Commissioner (" UPS "), T.C. Memo 1999-268, like most tax shelter cases, has a complicated fact pattern. UPS (the taxpayer) generally limits its liability for damages to goods in transit to $100, but customers may pay and UPS collects "excess value charges" (EVCs) to insure the packages for greater amounts. Prior to 1984, UPS retained all of the EVCs, paid all claims, and reported the income and deduction items on its return. Effective 1984, UPS restructured the manner in which it dealt with and reported EVCs. Although it did not change its practices for dealing with customers in handling receipts and claims, UPS began to remit the net EVCs (the total collected from customers and other shippers minus claims paid) to an unrelated insurance company (NUF), which in turn, after deducting certain fees, remitted the net EVCs as a reinsurance premium to OPL, a Bermudan insurance company. OPL had been formed by UPS and 97.33 percent of its stock was owned by UPS 's 14,000 shareholders, who had received the OPL stock as a dividend in a taxable spin-off. The OPL stock was subject to restrictions on transfer. After this arrangement was established, UPS no longer reported as income any of the EVCs collected and remitted to NUF, which amounted to almost $100 million for 1984 alone. However, UPS performed the same EVC functions and activities that it had previously performed, and it remained responsible for bad debts or uncollectible items because neither NUF nor OPL had any control over the customers' premium payments.

The Tax Court upheld the Service's determination that under the assignment of income doctrine UPS was taxable on the almost $100 million of EVCs paid to OPL in 1984, regardless of OPL's separate existence, which was accepted arguendo. *UPS* , T.C. Memo 1999-268. The Court found that the entire 1984 arrangement lacked business purpose and economic substance. The Court rejected UPS 's proffered business purpose - that its continued receipt of EVCs was potentially illegal under various state insurance laws - because no state insurance regulator ever questioned the prior practice. UPS never sought legal advice on the issue, Federal common carrier law probably preempted state law in any event, and if Federal law did not preempt state law, the 1984 practice was probably as violative of state law as the pre-1984 practice. The Court also was not convinced that the arrangement was designed to facilitate UPS rate increases. Nor was it impressed by UPS 's claim that a business purpose was to leverage the excess value profits into a new reinsurance company; the opinion noted that "any investment of money into [the subsidiary reinsurer] could accomplish this purpose." *UPS ,* T.C. Memo 1999- 268. After examining UPS 's pre-1984 reinsurance practices, which involved only claims over $25,000, and the fairly consistent 70 percent ratio of net EVCs retained to total EVCs collected, the Court rejected the UPS claim that the NUF/OPL arrangement sufficiently reduced the risk to UPS core transportation activity assets to have economic substance. Finally, the court found that there was contemporaneous documentation that the transaction was tax-motivated and concluded that the arrangement was "done for the purpose of avoiding taxes" and "had no economic substance or business purpose." *Id.* Because the EVC restructuring was found to be a sham transaction, the court denied UPS 's deduction for approximately $1 million retained by NUF. On appeal, the Eleventh Circuit considered whether the restructured insurance program had enough substance and business purpose to meet the economic substance doctrine. *United Parcel Service of America, Inc. v. Commissioner (" UPS ")*,254 F.3d 1014 (11th Cir. 2001). It defined the economic-substance doctrine as a two-pronged analysis. The first prong was whether the transaction had no other economic effects besides the creation of tax benefits. If a transaction passed the first prong and was found to have economic effects, then, according to the Eleventh Circuit, the analysis proceeded to the second prong.

The second prong of the analysis provided that despite economic effects, the transaction had to be disregarded if it had no business purpose and its motive was tax avoidance. (The Eleventh Circuit noted that this approach differs from the approach taken in *Rice's Toyota World, Inc., 752 F2d 89,* which required both a tax-avoidance purpose and a lack of economic effects.)

Proceeding under the above analytical framework, the Eleventh Circuit found that the UPS insurance restructuring had economic effects. The Eleventh Circuit relied on *Frank Lyon Co., 435 U.S. 561 (1978),* and held that, despite NUF's slight risk of loss on the deal, the transaction still had economic effects, because it comprised genuine exchanges of reciprocal obligations enforceable by unrelated parties. *UPS ,* 254 F.3d at 1018-20.

The Eleventh Circuit also considered the business-purpose and tax-avoidance motives, relying on *ACM Partnership v. Commissioner,* 157 F.3d 231 (3d Cir. 1998). The Eleventh Circuit explained that a transaction has business purpose as long as it figures in a bona fide profit-seeking business, and it emphasized that a valid business purpose does not require that the reasons for a transaction be free of tax considerations. *UPS ,* 254 F.3d at 1019.

In concluding that the insurance restructuring had economic substance and business purpose, the Eleventh Circuit reversed and remanded for consideration in the first instance of other arguments not addressed by the Tax Court (concerning under IRC § 482 and transfer pricing provisions of the Code). *UPS ,* 254 F.3d. at 1019-

Part III - Sources for Identification of Tax Shelters

Overview

Introduction

This section deals with sources of information that can help identify tax shelters, and which should be considered in the pre-audit analysis. These sources include:

- Information available through OTSA
- Technical Advisor information
- Return information
- Other information

Information Available Through OTSA

OTSA receives information from taxpayers, promoters, and field agents that is useful in determining whether tax shelter items are claimed on a return. Information is derived from:

- Disclosure statements
- Registration statements
- Tax shelter surveys
- Tax shelter hotline
- Informants
- Revenue agent audits

Additional Tools

A check sheet and IDRs were developed that aid in the identification of tax shelters.

- Corporate Tax Shelter Check Sheet
- IDRs

III .A. 1. Disclosure Statements

Introduction

Temporary Treasury Reg. §1.6011-4T, provides guidelines and requirements on disclosure statements as discussed below.

Who Must File

Every corporate taxpayer that is required to file a return for a taxable year with respect to a tax imposed under IRC §§ 11, 594, 801, or 831 and that has participated directly or indirectly in a "reportable transaction," must attach to its return a disclosure statement. A taxpayer will have indirectly participated in a transaction if its federal income tax liability is affected by the transaction, even if it is not a direct party to the transaction (e.g., it participates through a partnership or through a controlled entity). A separate disclosure statement is required for each "reportable transaction." A reportable transaction is either a listed transaction (or a substantially similar transaction), **or** a transaction which meets two out of five prescribed characteristics, **and** that meets the projected tax effect test. For details, definitions, characteristics, the projected tax effect test, and exceptions, see Temp. Treas. Reg. §1.6011-4T.

NOTE: Effective June 14, 2002, this regulation was modified to extend the same reporting requirements to individuals, trusts, partnerships, and S Corporations.

Time and Place

When participants in a "reportable transaction" file their tax returns, two copies of the disclosure statement are filed.

One copy is filed with the tax return **each year** that participation in the transaction affects the taxpayer's tax liability. The other copy is filed with the Office of Tax Shelter Analysis, 1111 Constitution Ave., NW , The Mint Building, Washington, DC 20224 at the same time the disclosure statement is **first** attached to the taxpayer's federal income tax return.

Effective Date

Temp. Treas. Reg. §1.6011-4T applies to federal corporate income tax returns filed after February 28, 2000. However, paragraphs (a) and (e) apply to federal corporate income tax returns filed after August 11, 2000, and to documents and other records that the taxpayer acquires, prepares, or has in its possession on or after August 11, 2000. Taxpayers may rely on the rules in paragraphs (a) and (e) for federal corporate income tax returns filed after February 28, 2000, and for documents and other records that the taxpayer acquires, prepares, or has in its possession on or after February 28, 2000. Otherwise, the rules that apply with respect to federal corporate income tax returns filed after February 28, 2000, and records that the taxpayer acquires, prepares, or has in its possession prior to August 11, 2000, are contained in Treas. Reg.§ 1.6011-4T in effect prior to August 11, 2000 (see 26 CFR part 1 revised as of April 1, 2000). [NOTE: These Temporary Regulations were revised in August of 2001. For details, see ***2001 TNT 156-70 - IRS Temporary Regulations.***]

Information to be Included in Disclosure Statements

The disclosure statement for each reportable transaction must include the information below and should be presented in a format preferably no longer than one page:

(i) The name or a short designation of the transaction (to distinguish it from other reportable transactions);

(ii) A statement indicating whether the transaction has been registered as a tax shelter, and if the transaction has been registered, an indication of whether Form 8271, "Investor Reporting of Tax Shelter Registration Number," has been filed with the taxpayer's return (this form provides the registration number);

(iii) A brief description of the transaction;

(iv) A brief description of the expected tax benefits of the transaction (e.g., loss deductions, interest deductions, rental deductions, foreign tax credits, etc.);

(v) An identification of each taxable year (including prior taxable years) for which the transaction is expected to have the effect of reducing the taxpayer's federal income tax liability, and an estimate (which may be rounded to the nearest $ 1 million) of the amount by which the transaction is expected to reduce the taxpayer's federal income tax liability for each such taxable year; and

(vi) The names and addresses of any parties who promoted, solicited, or recommended the taxpayer's participation in the transaction and who had a financial interest, including the receipt of fees, in the taxpayer's decision to participate.

Example

DISCLOSURE STATEMENT FOR REPORTABLE TRANSACTION Corporation X (EIN)

(address)

1. *Identification of transaction*: LILO --Country W.

2. *Registration status under IRC § 6111*: Not registered.

3. *Description of transaction*: We leased a building from a municipality in W. We made an advance payment of rent of $89 million. The lease term is 34 years. The foreign municipality subleased the asset back from us for a term of 20 years. The foreign municipality has the option, at the end of the sublease term, to buy out our interest for $50 million. Our advance lease payment has been financed with a bank loan of $60 million. The foreign municipality placed $75 million of the advance rental payment in special accounts to satisfy the sublease and buyout obligations.

4. *Principal tax benefits*: Deductions for rental and interest payments in excess of income from leaseback rental payments.

5. *Estimates of expected reduction of federal income tax Liability for affected taxable years*: 1999-2002, $5 million per year; 2003-2013, $4 million per year; and 2014-2017, $3 million per year.

6. *Promoters*:

Financial Institution Y

(address)

(telephone number)

Professional Service Firm Z

(address)

(telephone number)