

**Executive Summary of Comments on Temporary and Proposed Regulations
Regarding the Requirement to Maintain a List of Investors in Potentially
Abusive Tax Shelters submitted by the D.C. Bar Taxation Section**

On October 22, 2002, the Treasury Department issued new temporary and proposed tax shelter listing regulations obligating “material advisors” to maintain lists of persons they advise about potentially abusive tax shelter transactions. *See* Treas. Reg. § 301.6112-1T. The lists must include the names of the participants and describe the transaction. The material advisor must retain the list for ten years and furnish it upon request by the IRS (subject to claims of privilege).

On behalf of the D.C. Bar Taxation Section¹, we propose changes to the new regulations to fix three problems: (1) tax lawyers will not need to maintain lists of most tax audit and controversy matters (the “after-the-fact” problem); (2) material advisors will not need to maintain lists retroactively (the “retroactivity” problem); and (3) material advisors will not need to maintain lists of information that would be unreasonably difficult to obtain (the “unlimited information gathering” problem).

The new regulations apply a knowledge/timing requirement only to reportable transactions. Therefore, a person advising a participant about a listed or registered transaction would be a material advisor even if he had did not know (or have reason to know) about the transaction when the participant entered into it, which seems to include lawyers who advise tax audit or controversy clients.

To fix the after-the-fact problem, we propose applying the knowledge/timing requirement to all transactions by moving the requirement to the section defining “material advisor.” Limiting the list maintenance obligation to those who knew or should have known about the participant’s shelter transaction when it was sold is consistent with Code section 6112, which imposes a list maintenance obligation only on those who “organize” and “sell” tax shelters.

This change also fixes the retroactivity problem. Under our proposal, because the advisor must have known (or had reason to know) the transaction was listed at the time the participant entered into the transaction, the rules cannot apply retroactively. Several factors support making these rules prospective only. It is not clear what type of transaction fails to qualify for list maintenance today but might in the future. Prospective application is also consistent with the former list maintenance rules. *See* Former Temp. Treas. Reg. § 301.6112-1T, Q&A-22 (emphasis added). In any event, the IRS will receive notice of these transactions directly from participants under the new disclosure rules, which require taxpayers to disclose past transactions that later become listed or reportable. *See* Temp. Treas. Reg. § 1.6011-4T(e)(1).

¹ The views expressed herein represent only those of the District of Columbia Bar Taxation Section and not those of the District of Columbia Bar or its Board of Governors. The Section of Taxation is comprised of approximately 1,500 members. These materials were prepared by an *ad hoc* committee of the District of Columbia Bar. The members of the *ad hoc* committee are Andrea M. Whiteway (Chair), Rachel Cantor, Michael Cooper, Michael Desmond, Jeanne Falstrom, Bruce Larsen, Mark Liniado, Kelly Murray, Steven Rosenthal, Michael Rufkahr, and Charlie Temkin.

To fix the unlimited information gathering problem, we would add a provision that a material advisor who makes reasonable efforts to gather the required information satisfies the list maintenance obligation. We also propose adding language so that if one material advisor reasonably designates another material advisor to maintain the list, the designator only has to list whatever required information the designator already possesses to satisfy the list maintenance obligation.

A reasonableness standard is appropriate because material advisors may have limited access to the required information. Clients may regard certain information as confidential and refuse to provide it even upon request. Certain Code provisions also impose a reasonableness standard. For example, Code Section 857(f) requires real estate investment trusts annually to confirm their ownership of any outstanding shares or certificates of beneficial interest, but does not impose penalties if failure to satisfy this requirement is due to reasonable cause.

Material advisors should also be able to shift the requirement to obtain the required information (and thus limit their own obligation). Where the designated material advisor is competent to obtain the required information, the rules should not obligate the designator to obtain the same information, which may be costly to maintain. Regulations elsewhere authorize record-keepers to shift record-keeping responsibility through designation arrangements. *See, e.g.*, Treas. Reg. § 1.6045-4(e)(5).

Comments on Temporary and Proposed Regulations Regarding the Requirement to Maintain a List of Investors in Potentially Abusive Tax Shelters

The District of Columbia Bar Tax Section¹ makes the following comments on the Temporary and Proposed Regulations regarding the Requirement to Maintain a List of Investors in Potentially Abusive Tax Shelter issued on October 22, 2002 (the “New Regulations”) relating to list maintenance by material advisors.

We propose changes below (marked as bolded double underline for inserts and strikethrough for deletions) to the New Regulations to address the following problems: (1) tax lawyers will not need to maintain lists for most tax audit and controversy matters (the “after-the-fact” problem); (2) material advisors will not need to maintain lists retroactively (the “retroactivity” problem); and (3) material advisors will not need to maintain lists of information that would be unreasonably difficult to obtain (the “unlimited information gathering” problem).

Proposed Changes

To fix the after-the-fact and retroactivity problems, we propose shifting language from Temp. Treas. Reg. § 301.6112-1T(b)(2) to Temp. Treas. Reg. § 301.6112-1T (c)(2) as follows:

(b)(2) ***Transaction that has a potential for tax avoidance or evasion.***--A transaction that has a potential for tax avoidance or evasion is any transaction that is a listed transaction as defined in §1.6011-4T of this chapter and is subject to disclosure under §1.6011-4T, 20.6011-4T, 25.6011-4T, 31.6011-4T, 53.6011-4T, 54.6011-4T, or 56.6011-4T of this chapter, or any transaction that ~~a potential material advisor knows or has reason to know, at the time the transaction is entered into or an interest is acquired,~~ meets one of the categories of a reportable transaction under §1.6011-4T(b)(3) through (7) of this chapter.

(c)(2) ***Material advisor.***--A material advisor is any person who (or through its employees, shareholders, partners, or agents) receives, or expects to receive, at least a minimum fee, as defined in paragraph (c)(3) of this section, in connection with a transaction that **the person knows or has reason to know, at the time the transaction is entered into or an interest is acquired,** is a potentially abusive tax shelter and who makes or provides any statement, oral or written, to any **other** person as to the potential tax consequences of that transaction. A person shall be treated as a material advisor if that person forms or avails of an entity with the purpose of avoiding the rules of section 6111 or 6112 or the penalties under section 6707 or 6708.

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To fix the unlimited information gathering problem, we first propose inserting the following provision as new section Temp. Treas. Reg. § 301.6112-1T(e)(3)(iii):

A material advisor shall be treated as complying with this paragraph 3 if the advisor acts reasonably to fulfill the requirements hereof. No penalty shall be imposed on a material advisor for failing to include all the information described in this section in the list if it is shown that such failure is due to reasonable cause and not willful neglect.

We also propose revising Temp. Treas. Reg. §301.6112-1T(h) as follows:

Designation agreements.--If more than one material advisor is required to maintain a list of persons, in accordance with paragraph (e) of this section, for a potentially abusive tax shelter, the material advisors may designate by written agreement a single material advisor to maintain the list or a portion of the list. **If the designation of a single material advisor to maintain the list or portion thereof is reasonable, a material advisor who enters into a designation agreement shall be relieved of the requirements of paragraph (3) to the extent that such requirements would impose upon the material advisor the obligation to gather information that the material advisor does not already have available.** The designation of one material advisor to maintain the list does not relieve the other material advisors from their obligation to furnish the list to the Internal Revenue Service in accordance with paragraph (g) of this section **in the event that the designation is not reasonable.** ~~The fact that a material advisor is unable to obtain the list from any designated material advisor, the fact that any designated material advisor did not maintain a list, or the fact that the list maintained by any designated material advisor is not complete, will not relieve any material advisor from the requirements of this section.~~

Explanation

The “After-the-Fact” Problem

The New Regulations include a knowledge/timing requirement that applies only to reportable transactions. Therefore, a person advising a participant about a listed or registered transaction would be a material advisor even if he did not know (or have reason to know) about the transaction when the participant entered into the transaction. The list maintenance obligation would thus seem to extend to lawyers advising tax audit or controversy clients.

We propose applying the knowledge/timing requirement to all “potentially abusive tax shelter” transactions by moving the requirement to the section defining “material advisor.” Limiting the list maintenance obligation to advisors who knew or should have known that this participant’s transaction was a potentially abusive tax shelter at the time the participant entered into the transaction is consistent with Code Section 6112, which imposes a list maintenance obligation only on those who “organize” and “sell” tax shelters. The legislative history to Code

section 6112 also refers to organizers and sellers, not to advisors on audit or controversy. *See* H.Rep. No. 98-432, Pt. 2 (March 5, 1984), at 1351-52.

The “Retroactivity” Problem

Our proposal also prevents the list maintenance obligation from applying retroactively. If a transaction becomes a listed transaction on or after January 1, 2003, the New Regulations apply to transactions entered into on or after February 28, 2000 (if the transaction involves income taxes), or on or after January 1, 2003 (if the transaction involves non-income taxes). Under our proposal, the advisor must have known (or had reason to know) the transaction was a listed transaction at the time the participant entered into the transaction, so the list maintenance obligation cannot apply retroactively.

Several factors support making the list maintenance obligation prospective only. First, a retroactive obligation is unduly vague. The regulations do not provide guidance on what type of transaction fails to qualify for list maintenance today but might qualify in the future. Therefore, material advisors will have difficulty deciding which transactions they should begin maintaining lists for today. Alternatively, if material advisors wait to find out which transactions become listed transactions, they may not have kept information about past participants.

Second, retroactivity may place an unwieldy administrative burden on material advisors. Because material advisors cannot predict which transactions will become listed transactions, they might feel compelled to maintain lists of all transactions to ensure compliance.

Third, prospective application is consistent with the former list maintenance obligations. If a transaction later became a listed transaction, the material advisor had to maintain the list only with respect to “any interest in the transaction acquired after the transaction becomes a potentially abusive tax shelter.” *See* Former Temp. Treas. Reg. § 301.6112-1T, Q&A-22 (emphasis added).

Finally, the IRS should receive notice of these transactions directly from the taxpayers in any event. The new disclosure rules require taxpayers to disclose past transactions that later become listed or reportable by attaching a statement to the taxpayer's tax return next filed whether or not the transaction affects the taxpayer's tax liability for that year. *See* Temp. Treas. Reg. § 1.6011-4T(e)(1).

The “Unlimited Information Gathering” Problem

Under the New Regulations, material advisors will not satisfy the list maintenance obligation if they reasonably attempt to acquire the required information but fail to do so. Our proposal permits material advisors to comply by making reasonable efforts to gather the required information.

Several factors support a reasonableness standard. First, a material advisor may have limited access to the required information depending on the client and the type of transaction. Clients may regard such information as confidential and refuse to provide it even upon request.

Second, other Code provisions suggest that, for an information gathering obligation, a reasonableness standard is appropriate. For example, Code Section 857(f) requires real estate investment trusts annually to confirm their ownership of any outstanding shares or certificates of beneficial interest, but does not impose penalties if failure to satisfy this obligation is due to reasonable cause.

In addition, under the New Regulations, designating the responsibility to maintain the lists to another material advisor does not relieve the designator from the obligation of maintaining lists of all the required information. Thus, it is not clear whether the ability to designate serves a useful purpose. Under our proposal, by contrast, if one material advisor reasonably designates another material advisor to maintain the list, the designator only has to list whatever required information the designator already possesses to satisfy the list maintenance obligation.

Material advisors should be able to shift the requirement to obtain the required information (and thus limit their own obligation) for several reasons. Where a material advisor reasonably concludes that the designated material advisor is competent to obtain and list the required information, the rules should limit the designator's own list maintenance obligation rather than obligate the designator to obtain the same information. Moreover, material advisors may incur substantial costs to maintain such a list, and these costs would be redundant if more than one material advisor must obtain all the required information for the same transactions. Regulations elsewhere authorize record-keepers to shift record-keeping responsibility through designation arrangements. *See, e.g.*, Treas. Reg. § 1.6045-4(e)(5).