Tax Compliance – A Practitioner's Viewpoint

2004 FTA Annual Meeting Providence, RI June 7, 2004

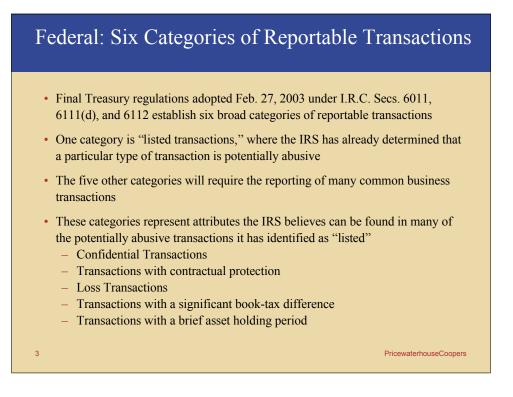
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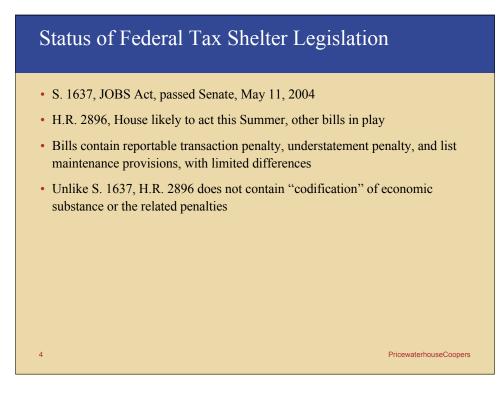
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Introduction

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- Final Treasury regulations require the reporting of potential tax shelters, the registration of confidential corporate tax shelters, and the maintenance of investor lists by tax shelter promoters
- Current Federal legislative proposals would impose penalties for failure to disclose reportable transactions, increased accuracy penalties on certain nondisclosed transactions, and penalties for failure to maintain investor lists
- Current Federal legislative proposals also include "codification" of economic substance and related penalties
- California has enacted its own reportable transaction disclosure, registration, and penalty regime, with other states considering varying regimes
- · Various states have codified, or proposed, various economic substance standards
- Varying state tax shelter regimes and economic substance laws that conflict with Federal law and practice could greatly complicate state administration and frustrate taxpayer and practitioner compliance efforts





Some Examples From Current S. 1637, as passed the Senate, May 11, 2004

- Per se penalty for failure to disclose listed transaction
 - \$200,000 for "large entity" or "high net-worth individual"
 - \$100,000 for others
 - SEC reporting requirement
- · Penalty for failure to disclose reportable transaction
 - \$100,000 for "large entity" or "high net-worth individual"
 - \$50,000 for others

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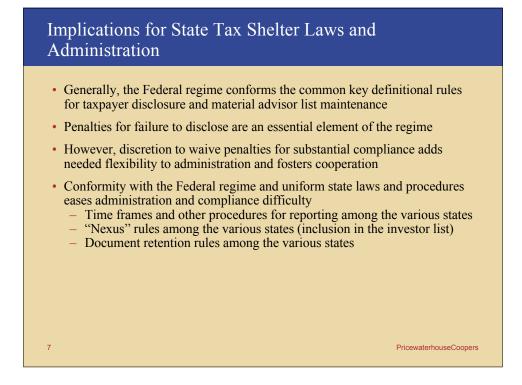
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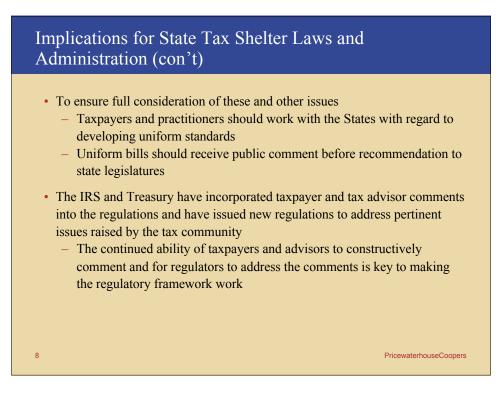
- Limited discretion to rescind penalty
- · Accuracy-related penalty on "reportable transaction understatements"
 - Disclosed transaction: 20%
 - Nondisclosed transaction: 30%
 - Limited "reasonable cause" exception
 - SEC reporting requirement
- Would allow the Secretary to disclose company names and the amount of 1) penalties imposed for failure to disclose a listed transaction, 2) 30% enhanced understatement penalties, and 3) all penalties imposed with respect to non-economic substance transactions

Current S. 1637 (con't)

- Each material advisor with respect to any reportable transaction must maintain a list identifying each person with respect to whom the advisor acted as such a material advisor
- Penalty for failure to make such list available within 20 business days after the date of the Secretary's request would be \$10,000 for each subsequent day
- Penalty for promoting abusive tax shelters not to exceed 100 percent of the gross income derived (or to be derived) from such activity
- Penalty for failure to furnish information
 - For listed transactions, the greater of \$200,000 or 50% of the gross income derived from aid, assistance, or advice which is provided with respect to the listed transaction
 - For other reportable transactions, \$50,000

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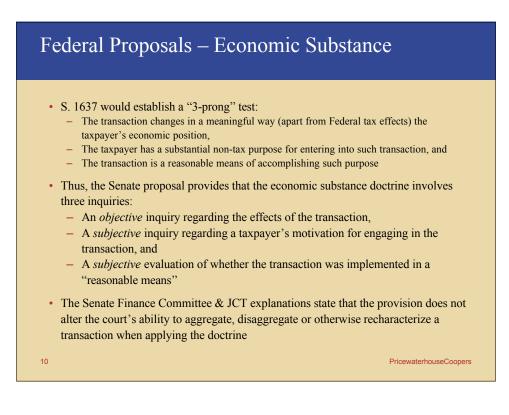


- Under present law, there is no Federal statutory requirement that all transactions demonstrate economic substance
- The judicial standard for establishing economic substance varies among the U.S. Circuit Courts and is often considered in conjunction with another common law doctrine, the "business purpose" test
 - United Parcel Service (11th Cir.)
 - Winn-Dixie (11th Cir.)
 - Compaq (5th Cir.)

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- Rice's Toyota World (4th Cir.)
- There is a lack of uniformity regarding
 - Definition of the doctrine "Two-prong" economic substance/business purpose test versus either economic substance test or business purpose

- When the test(s) should be applied
- What level of profit potential is necessary



Federal Proposals – Noneconomic Substance Transaction Understatements

- S. 1637 would impose accuracy-related penalties on understatements attributable to certain "Noneconomic Substance Transactions"
- "Noneconomic Substance Transactions" are those that:
 - Lack economic substance,
 - Are not respected under the rules relating to tax-indifferent parties, or
 - Fail to meet the requirements of "any similar rule of law" (e.g., a transaction determined to be a "sham transaction")
- The penalty would be 20% if the transaction were disclosed and 40% if not disclosed.
- No exceptions available under the proposal

California: Non-Economic Substance Transaction Understatement

- Enacted pursuant to S.B. 614 and A.B. 1601, signed into law on October 2, 2003
- "A transaction shall be treated as lacking economic substance if the taxpayer does not have a valid nontax California business purpose for entering into the transaction."
- Does not provide further definition, but imports business purpose into the penalty determination
- · Likely to be based on common law substance doctrine
- Penalties

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- 40% of the amount of the understatement or
- 20% of the amount of the understatement, if the relevant facts are adequately disclosed

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