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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 20, 25, 31, 53, 54, and 56

REG-103038-05

RIN 1545-BE24

AJCA Modifications to the Section 6011 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document contains proposed regulations under section 6011 of the Internal Revenue Code that modify the rules relating to the disclosure of reportable transactions under section 6011. These regulations affect taxpayers participating in reportable transactions under section 6011, material advisors responsible for disclosing reportable transactions under section 6011, and material advisors responsible for keeping lists under section 6012.

DATES: Written or electronic comments and requests for a public hearing must be received by January 31, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-103038-05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-103038-05), Courier's Desk, Internal Revenue Service, Crystal Mall 4 Building, 1901 S. Bell St., Arlington, VA., or sent electronically, via

the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG-103038-05).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Tara P. Volungis or Charles Wien, 202-622-3070; concerning the submissions of comments and requests for hearing, Kelly Banks, 202-622-0392 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Background**

This document proposes to amend 26 CFR part 1 by modifying and clarifying the rules relating to the disclosure of reportable transactions under section 6011. This document also proposes to amend 26 CFR parts 20, 25, 31, 53, 54, and 56 by modifying the rules for purposes of estate, gift, employment, and pension and exempt organizations excise taxes that require the disclosure of listed transactions by certain taxpayers on their Federal tax returns under section 6011.

On February 28, 2003, the IRS issued final regulations under sections 6011, 6111, and 6112 (TD 9046) (the February 2003 regulations). The February 2003 regulations were published in the **Federal Register** (68 FR 10161) on March 4, 2003. On December 29, 2003, the IRS issued final regulations under section 6011 and 6112 (TD 9108) (the December 2003 regulations). The December 2003 regulations were published in the **Federal Register** (68 FR 75128) on December 30, 2003.

Since the publication of the February 2003 regulations and the December 2003 regulations, the American Jobs Creation Act of 2004, Public Law 108-357, 118 Stat. 1418,

(AJCA) was enacted on October 22, 2004. The AJCA revised sections 6111 and 6112, thereby necessitating changes to the rules under section 6011. The IRS and Treasury Department also have received various comments and questions regarding the rules under §1.6011-4. Consequently, the IRS and Treasury Department are proposing modifications to the rules regarding the disclosure of reportable transactions under §1.6011-4.

It should be noted that section 516 of the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109-222, 120 Stat. 345, (TIPRA), enacted on May 17, 2006, includes new excise taxes that target prohibited tax shelter transactions to which a tax-exempt entity is a party. Prohibited tax shelter transactions consist of listed transactions, confidential transactions, and transactions with contractual protection under section 6011. TIPRA also contains new disclosure requirements, which apply not only to tax-exempt entities but also to taxable entities that are parties to prohibited tax shelter transactions involving tax-exempt entities, and makes penalties applicable for failure to comply with each new disclosure requirement. The IRS and Treasury Department will issue separate guidance regarding the disclosure provision in TIPRA.

## **Explanation of Provisions**

### **A. Removal of Transactions with a Significant Book-Tax Difference**

Under the current regulations in §1.6011-4, there are six categories of reportable transactions. In accordance with the interim guidance provided in Notice 2006-6, 2006-5 I.R.B. 385, these proposed regulations eliminate the transactions with a significant book-tax difference category of reportable transaction that is in §1.6011-4(b)(6). The IRS and

Treasury Department have determined that this category of reportable transaction is no longer necessary due to the issuance of the Schedule M-3, "Net Income (Loss) Reconciliation For Corporations With Total Assets of \$10 Million or More", which now provides the IRS a more complete disclosure of book-tax differences for corporations. The Schedule M-3 reporting requirements will be extended to partnerships and S corporations. The removal of the book-tax difference category applies to transactions that otherwise would have to have been disclosed on or after January 6, 2006 (regardless of when the transaction was entered into).

#### B. Transactions of Interest

The IRS and Treasury Department are proposing as a new category of reportable transaction the transactions of interest reportable transaction. A transaction of interest is a transaction that the IRS and Treasury Department believe has a potential for tax avoidance or evasion, but for which the IRS and Treasury Department lack enough information to determine whether the transaction should be identified specifically as a tax avoidance transaction. Transactions of interest will be identified in published guidance. When the IRS and Treasury Department have gathered enough information to make an informed decision as to whether the transaction of interest is a tax avoidance type of transaction, the IRS and Treasury Department may take one or more actions, including removing the transaction from the transactions of interest category in published guidance, designating the transaction as a listed transaction, or providing a new category of reportable transaction. Listed transactions do not have to be identified as transactions of interest before the transactions

are identified as listed transactions. It is anticipated that, upon finalization of these proposed regulations, the transactions of interest category of reportable transaction will apply to transactions entered into on or after November 2, 2006.

### C. Lease Transactions

These proposed regulations also eliminate the special rule for lease transactions. Under the current regulations this special rule provides that certain customary commercial leases of tangible personal property described in Notice 2001-18, 2001-1 C.B. 731, are excluded from all of the reportable transaction categories except listed transactions. Notice 2001-18 originally was published prior to the AJCA to provide exceptions from the confidential corporate tax shelter registration requirements under section 6111(d) and the list maintenance requirements under section 6112. The special rule for lease transactions that cross-references Notice 2001-18 was added to §1.6011-4 in TD 9046 in February 2003. At that time, the IRS and Treasury Department were concerned that customary commercial lease transactions routinely would fall under the significant book-tax difference category of reportable transaction. The public also expressed concern that many customary leasing transactions would trigger the confidential transaction category of reportable transaction that was published in the temporary regulations under §1.6011-4T in TD 9017 in October 2002 (and in the February 2003 regulations). Since the publication of the February 2003 regulations, the IRS and Treasury Department amended the confidential transaction category of reportable transaction in the December 2003 regulations, the AJCA removed the confidential corporate tax shelter provision in section 6111(d) in October 2004, and

Notice 2006-6 signaled the removal of the significant book-tax difference transaction category of reportable transaction.

Because the confidential transaction category has been narrowed and the significant book-tax difference transaction category is being removed, the IRS and Treasury Department believe that leasing transactions should be subject to the same disclosure rules as other transactions. While the IRS and Treasury Department do believe the disclosure rules should apply to all leasing transactions, the IRS and Treasury Department also believe that most customary commercial leasing transactions will not meet the reportable transaction requirements and will not be subject to disclosure. The IRS and Treasury Department intend to obsolete Notice 2001-18 when these proposed regulations are finalized. Comments regarding the removal of this exception, the transactions that will have to be disclosed as a consequence, if any, and the possibility of exceptions for specific types of leasing transactions as to each category of reportable transaction are requested.

#### D. Transactions Involving a Brief Asset Holding Period

These proposed regulations also modify the transactions involving a brief asset holding period category of reportable transaction in §1.6011-4(b)(7). Section 901(l), added to the Code by the AJCA, and section 901(k) operate to disallow foreign tax credits for withholding and certain other foreign taxes imposed on dividends or other income or gain with respect to property if the taxpayer does not meet a minimum holding period. In light of the enactment of section 901(l), the proposed regulations amend the brief asset holding period category to exclude transactions resulting in a claimed foreign tax credit.

#### E. Protective Disclosures

The IRS receives disclosures that taxpayers file on a protective basis, claiming that the transactions are not subject to disclosure under section 6011. Some of those taxpayers fail to provide the IRS with the information requested under section 6011 and the regulations thereunder that would enable the IRS to make a determination as to whether the transaction is subject to disclosure. Consequently, the IRS and Treasury Department have added clarifying language in the proposed regulations that allows protective disclosures to be filed in situations where a taxpayer is unsure of whether the transaction should be disclosed under section 6011 if the taxpayer complies with the rules of §1.6011-4 as if the transaction is subject to disclosure and the person furnishes the IRS the information requested under these regulations.

#### F. Partners, Shareholders, and Beneficiaries

The IRS and Treasury Department are aware of situations in which partners, shareholders, and beneficiaries have filed their Federal tax returns before receiving Schedule K-1s from the partnership, S corporation or trust that participated in a reportable transaction. The proposed regulations address this problem by providing that if a taxpayer in a partnership, S corporation, or trust receives a timely Schedule K-1 less than 10 calendar days before the due date of the taxpayer's return (including extensions) and, based on receipt of the timely Schedule K-1, the taxpayer determines that the taxpayer participated in a reportable transaction, the disclosure statement will not be considered late if the taxpayer discloses the reportable transaction by filing a disclosure statement with

OTSA within 45 calendar days after the due date of the taxpayer's return (including extensions). A taxpayer filing a disclosure statement in accordance with this provision need only file the statement with OTSA and need not file an amended return to make the disclosure. This provision is proposed to be applicable for transactions entered into on or after the date these regulations are published as final regulations in the **Federal Register**. However, taxpayers currently may rely on this provision in the proposed regulations, and taxpayers who have filed a disclosure statement with OTSA within 45 calendar days after the due date of the taxpayer's return (including extensions) as provided in this provision have satisfied the disclosure requirements under §1.6011-4. The IRS and Treasury Department solicit comments on whether there may be other situations in which a taxpayer may not know or have reason to know of its participation in a reportable transaction at the time the return is filed and ways in which the disclosure rules could address these situations.

#### G. Tolling Provision

Other proposed changes relate to the provisions for obtaining a private letter ruling and the tolling of the time for providing disclosure during the time the request for a ruling is pending. Because the IRS and Treasury Department believe that the removal of the tolling provision will promote effective tax administration, these proposed regulations eliminate the tolling of the time for providing disclosure when a taxpayer requests a private letter ruling. Temporary regulations removing the tolling provision are being issued concurrently with these proposed regulations. Taxpayers may still request a ruling on a transaction under the

regular procedures for requesting a ruling, provided the ruling request is not factual or hypothetical, but the time for providing disclosure will not be tolled. The removal of the tolling provision is effective for all ruling requests received on or after November 1, 2006.

#### H. Other Clarifications and Modifications

These proposed regulations also clarify and/or modify other provisions under §1.6011-4. The regulations for estate, gift, employment, and pension and exempt organizations excise taxes are proposed to be modified by making them applicable to transactions of interest.

#### I. Comments

The IRS and Treasury Department are aware of concerns expressed by commentators regarding the patenting of tax advice or tax strategies. The IRS and Treasury Department share these concerns and are exploring ways in which they could be addressed, including through the creation of a new category of reportable transaction. Comments are requested regarding the creation of such a category of reportable transaction. Comments also are requested on all proposed changes to the regulations.

#### J. Effective Date

Generally, when these proposed regulations become final, they will apply to transactions entered into on or after the date these regulations are published as final regulations in the Federal Register. However, upon publication the final regulations will apply to transactions of interest entered into on or after November 2, 2006.

#### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. The disclosure statement referenced in these regulations will be made available for public comment in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35). Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules, how they can be made easier to understand, and the administrability of the rules in the proposed regulations. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that submits timely written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

## **Drafting Information**

The principal authors of these regulations are Tara P. Volungis and Charles Wien, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

## **List of Subjects**

### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### 26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

### 26 CFR Part 25

Gift taxes, Reporting and recordkeeping requirements.

### 26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

### 26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and recordkeeping requirements.

### 26 CFR Part 54

Excise taxes, Pensions, Reporting and recordkeeping requirements.

### 26 CFR Part 56

Excise taxes, Lobbying, Nonprofit organizations, Reporting and recordkeeping

requirements.

## **Proposed Amendments to the Regulations**

Accordingly, 26 CFR parts 1, 20, 25, 31, 53, 54, and 56 are proposed to be amended as follows:

### **PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.6011-4 is revised to read as follows:

§1.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) In general. Every taxpayer that has participated, as described in paragraph (c)(3) of this section, in a reportable transaction within the meaning of paragraph (b) of this section and who is required to file a tax return must attach to its return for the taxable year described in paragraph (e) of this section a disclosure statement in the form prescribed by paragraph (d) of this section. The fact that a transaction is a reportable transaction shall not affect the legal determination of whether the taxpayer's treatment of the transaction is proper.

(b) Reportable transactions--(1) In general. A reportable transaction is a transaction described in any of the paragraphs (b)(2) through (7) of this section. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan.

There are six categories of reportable transactions: listed transactions, confidential

transactions, transactions with contractual protection, loss transactions, transactions of interest, and transactions involving a brief asset holding period.

(2) Listed transactions. 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 (IRS) has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.

(3) Confidential transactions--(i) In general. A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee.

(ii) Conditions of confidentiality. A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction.

(iii) Minimum fee. For purposes of this paragraph (b)(3), the minimum fee is:

(A) \$250,000 for a transaction if the taxpayer is a corporation.

(B) \$50,000 for all other transactions unless the taxpayer is a partnership or trust, all

of the owners or beneficiaries of which are corporations (looking through any partners or beneficiaries that are themselves partnerships or trusts), in which case the minimum fee is \$250,000.

(iv) Determination of minimum fee. For purposes of this paragraph (b)(3), in determining the minimum fee, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction are taken into account. Fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent return preparation fees are unreasonable in light of the facts and circumstances. For purposes of this paragraph (b)(3), a taxpayer also is treated as paying fees to an advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the advisor, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property. The IRS will scrutinize carefully all of the facts and circumstances in determining whether consideration received in connection with a confidential transaction constitutes fees.

(v) Related parties. For purposes of this paragraph (b)(3), persons who bear a relationship to each other as described in section 267(b) or 707(b) will be treated as the same person.

(4) Transactions with contractual protection--(i) In general. A transaction with contractual protection is a transaction for which the taxpayer or a related party (as described in section 267(b) or 707(b)) has the right to a full or partial refund of fees (as described in paragraph (b)(4)(ii) of this section) if all or part of the intended tax consequences from the transaction are not sustained. A transaction with contractual protection also is a transaction for which fees (as described in paragraph (b)(4)(ii) of this section) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the transaction will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to the transaction have not designated as fees or any agreement to provide services without reasonable compensation.

(ii) Fees. Paragraph (b)(4)(i) of this section only applies with respect to fees paid by or on behalf of the taxpayer or a related party to any person who makes or provides a statement, oral or written, to the taxpayer or related party (or for whose benefit a statement is made or provided to the taxpayer or related party) as to the potential tax consequences that may result from the transaction.

(iii) Exceptions--(A) Termination of transaction. A transaction is not considered to have contractual protection solely because a party to the transaction has the right to terminate the transaction upon the happening of an event affecting the taxation of one or more parties to the transaction.

(B) Previously reported transaction. If a person makes or provides a statement to a

taxpayer as to the potential tax consequences that may result from a transaction only after the taxpayer has entered into the transaction and reported the consequences of the transaction on a filed tax return, and the person has not previously received fees from the taxpayer relating to the transaction, then any refundable or contingent fees are not taken into account in determining whether the transaction has contractual protection. This paragraph (b)(4) does not provide any substantive rules regarding when a person may charge refundable or contingent fees with respect to a transaction. See Circular 230, 31 CFR Part 10, for the regulations governing practice before the IRS.

(5) Loss transactions--(i) In general. A loss transaction is any transaction resulting in the taxpayer claiming a loss under section 165 of at least--

(A) \$10 million in any single taxable year or \$20 million in any combination of taxable years for corporations;

(B) \$10 million in any single taxable year or \$20 million in any combination of taxable years for partnerships that have only corporations as partners (looking through any partners that are themselves partnerships), whether or not any losses flow through to one or more partners; or \$2 million in any single taxable year or \$4 million in any combination of taxable years for all other partnerships, whether or not any losses flow through to one or more partners;

(C) \$2 million in any single taxable year or \$4 million in any combination of taxable years for individuals, S corporations, or trusts, whether or not any losses flow through to one or more shareholders or beneficiaries; or

(D) \$50,000 in any single taxable year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership, if the loss arises with respect to a section 988 transaction (as defined in section 988(c)(1) relating to foreign currency transactions).

(ii) Cumulative losses. In determining whether a transaction results in a taxpayer claiming a loss that meets the threshold amounts over a combination of taxable years as described in paragraph (b)(5)(i) of this section, only losses claimed in the taxable year that the transaction is entered into and the five succeeding taxable years are combined.

(iii) Section 165 loss. (A) For purposes of this section, in determining the thresholds in paragraph (b)(5)(i) of this section, the amount of a section 165 loss is adjusted for any salvage value and for any insurance or other compensation received. See ' 1.165-1(c)(4). However, a section 165 loss does not take into account offsetting gains, or other income or limitations. For example, a section 165 loss does not take into account the limitation in section 165(d) (relating to wagering losses) or the limitations in sections 165(f), 1211, and 1212 (relating to capital losses). The full amount of a section 165 loss is taken into account for the year in which the loss is sustained, regardless of whether all or part of the loss enters into the computation of a net operating loss under section 172 or a net capital loss under section 1212 that is a carryback or carryover to another year. A section 165 loss does not include any portion of a loss, attributable to a capital loss carryback or carryover from another year, that is treated as a deemed capital loss under section 1212.

(B) For purposes of this section, a section 165 loss includes an amount deductible

pursuant to a provision that treats a transaction as a sale or other disposition, or otherwise results in a deduction under section 165. A section 165 loss includes, for example, a loss resulting from a sale or exchange of a partnership interest under section 741 and a loss resulting from a section 988 transaction.

(6) Transactions of interest. A transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.

(7) Transactions involving a brief asset holding period. A transaction involving a brief asset holding period is any transaction resulting in the taxpayer claiming a tax credit (other than a foreign tax credit) exceeding \$250,000 if the underlying asset giving rise to the credit is held by the taxpayer for 45 days or less. For purposes of determining the holding period, the principles of section 246(c)(3) and (c)(4) apply.

(8) Exceptions--(i) In general. A transaction will not be considered a reportable transaction, or will be excluded from any individual category of reportable transaction under paragraphs (b)(3) through (7) of this section, if the Commissioner makes a determination by published guidance that the transaction is not subject to the reporting requirements of this section. The Commissioner may make a determination by individual letter ruling under paragraph (f) of this section that an individual letter ruling request on a specific transaction satisfies the reporting requirements of this section with regard to that transaction for the taxpayer who requests the individual letter ruling.

(ii) Special rule for RICs. For purposes of this section, a regulated investment

company (RIC) as defined in section 851 or an investment vehicle that is owned 95 percent or more by one or more RICs at all times during the course of the transaction are not required to disclose a transaction that is described in any of paragraphs (b)(3) through (5) and (b)(7) of this section unless the transaction is also a listed transaction or a transaction of interest.

(c) Definitions. For purposes of this section, the following definitions apply:

(1) Taxpayer. The term taxpayer means any person described in section 7701(a)(1), including S corporations. Except as otherwise specifically provided in this section, the term taxpayer also includes an affiliated group of corporations that joins in the filing of a consolidated return under section 1501.

(2) Corporation. When used specifically in this section, the term corporation means an entity that is required to file a return for a taxable year on any 1120 series form, or successor form, excluding S corporations.

(3) Participation--(i) In general--(A) Listed transactions. A taxpayer has participated in a listed transaction if the taxpayer's tax return reflects tax consequences or a tax strategy described in the published guidance that lists the transaction under paragraph (b)(2) of this section. A taxpayer also has participated in a listed transaction if the taxpayer knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from tax consequences or a tax strategy described in published guidance that lists a transaction under paragraph (b)(2) of this section. Published guidance may identify other types or classes of persons that will be treated as participants in a listed transaction. Published

guidance also may identify types or classes of persons that will not be treated as participants in a listed transaction.

(B) Confidential transactions. A taxpayer has participated in a confidential transaction if the taxpayer's tax return reflects a tax benefit from the transaction and the taxpayer's disclosure of the tax treatment or tax structure of the transaction is limited in the manner described in paragraph (b)(3) of this section. If a partnership's, S corporation's or trust's disclosure is limited, and the partner's, shareholder's, or beneficiary's disclosure is not limited, then the partnership, S corporation, or trust, and not the partner, shareholder, or beneficiary, has participated in the confidential transaction.

(C) Transactions with contractual protection. A taxpayer has participated in a transaction with contractual protection if the taxpayer's tax return reflects a tax benefit from the transaction and, as described in paragraph (b)(4) of this section, the taxpayer has the right to the full or partial refund of fees or the fees are contingent. If a partnership, S corporation, or trust has the right to a full or partial refund of fees or has a contingent fee arrangement, and the partner, shareholder, or beneficiary does not individually have the right to the refund of fees or a contingent fee arrangement, then the partnership, S corporation, or trust, and not the partner, shareholder, or beneficiary, has participated in the transaction with contractual protection.

(D) Loss transactions. A taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a section 165 loss and the amount of the section 165 loss equals or exceeds the threshold amount applicable to the taxpayer as described in

paragraph (b)(5)(i) of this section. If a taxpayer is a partner in a partnership, shareholder in an S corporation, or beneficiary of a trust and a section 165 loss as described in paragraph (b)(5) of this section flows through the entity to the taxpayer (disregarding netting at the entity level), the taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a section 165 loss and the amount of the section 165 loss that flows through to the taxpayer equals or exceeds the threshold amounts applicable to the taxpayer as described in paragraph (b)(5)(i) of this section. For this purpose, a tax return is deemed to reflect the full amount of a section 165 loss described in paragraph (b)(5) of this section allocable to the taxpayer under this paragraph (c)(3)(i)(D), regardless of whether all or part of the loss enters into the computation of a net operating loss under section 172 or net capital loss under section 1212 that the taxpayer may carry back or carry over to another year.

(E) Transactions of interest. A taxpayer has participated in a transaction of interest if the taxpayer is one of the types or classes of persons identified as participants in the transaction in the published guidance describing the transaction of interest.

(F) Transactions involving a brief asset holding period. A taxpayer has participated in a transaction involving a brief asset holding period if the taxpayer's tax return reflects items giving rise to a tax credit described in paragraph (b)(7) of this section. If a taxpayer is a partner in a partnership, shareholder in an S corporation, or beneficiary of a trust and the items giving rise to a tax credit described in paragraph (b)(7) of this section flow through the entity to the taxpayer (disregarding netting at the entity level), the taxpayer has participated in a transaction involving a brief asset holding period if the taxpayer's tax return reflects the

tax credit and the amount of the tax credit claimed by the taxpayer exceeds \$250,000.

(G) Shareholders of foreign corporations--(1) In general. A reporting shareholder of a foreign corporation participates in a transaction described in paragraphs (b)(2) through (5) and (b)(7) of this section if the foreign corporation would be considered to participate in the transaction under the rules of this paragraph (c)(3) if it were a domestic corporation filing a tax return that reflects the items from the transaction. A reporting shareholder of a foreign corporation participates in a transaction described in paragraph (b)(6) of this section only if the published guidance identifying the transaction includes the reporting shareholder among the types or classes of persons identified as participants. A reporting shareholder (and any successor in interest) is considered to participate in a transaction under this paragraph (c)(3)(i)(G) only for its first taxable year with or within which ends the first taxable year of the foreign corporation in which the foreign corporation participates in the transaction, and for the reporting shareholder's five succeeding taxable years.

(2) Reporting shareholder. The term reporting shareholder means a United States shareholder (as defined in section 951(b)) in a controlled foreign corporation (as defined in section 957) or a 10 percent shareholder (by vote or value) of a qualified electing fund (as defined in section 1295).

(ii) Examples. The following examples illustrate the provisions of paragraph (c)(3)(i) of this section:

Example 1. Notice 2003-55 (2003-2 C.B. 395), which modified and superseded Notice 95-53 (1995-2 C.B. 334) (see ' 601.601(d)(2) of this chapter), describes a lease stripping transaction in which one party (the transferor) assigns the right to receive future payments under a lease of tangible property and treats the amount realized from the assignment as its current income. The transferor later transfers the property subject to the

lease in a transaction intended to qualify as a transferred basis transaction, for example, a transaction described in section 351. The transferee corporation claims the deductions associated with the high basis property subject to the lease. The transferor's and transferee corporation's tax returns reflect tax positions described in Notice 2003-55. Therefore, the transferor and transferee corporation have participated in the listed transaction. In the section 351 transaction, the transferor will have received stock with low value and high basis from the transferee corporation. If the transferor subsequently transfers the high basis/low value stock to a taxpayer in another transaction intended to qualify as a transferred basis transaction and the taxpayer uses the stock to generate a loss, and if the taxpayer knows or has reason to know that the tax loss claimed was derived indirectly from the lease stripping transaction, then the taxpayer has participated in the listed transaction. Accordingly, the taxpayer must disclose the transaction and the manner of the taxpayer's participation in the transaction under the rules of this section. For purposes of this example, if a bank lends money to the transferor, transferee corporation, or taxpayer for use in their transactions, the bank has not participated in the listed transaction because the bank's tax return does not reflect tax consequences or a tax strategy described in the listing notice (nor does the bank's tax return reflect a tax benefit derived from tax consequences or a tax strategy described in the listing notice) nor is the bank described as a participant in the listing notice.

Example 2. XYZ is a limited liability company treated as a partnership for tax purposes. X, Y, and Z are members of XYZ. X is an individual, Y is an S corporation, and Z is a partnership. XYZ enters into a confidential transaction under paragraph (b)(3) of this section. XYZ and X are bound by the confidentiality agreement, but Y and Z are not bound by the agreement. As a result of the transaction, XYZ, X, Y, and Z all reflect a tax benefit on their tax returns. Because XYZ's and X's disclosure of the tax treatment and tax structure are limited in the manner described in paragraph (b)(3) of this section and their tax returns reflect a tax benefit from the transaction, both XYZ and X have participated in the confidential transaction. Neither Y nor Z has participated in the confidential transaction because they are not subject to the confidentiality agreement.

Example 3. P, a corporation, has an 80% partnership interest in PS, and S, an individual, has a 20% partnership interest in PS. P, S, and PS are calendar year taxpayers. In 2006, PS enters into a transaction and incurs a section 165 loss (that does not meet any of the exceptions to a section 165 loss identified in published guidance) of \$12 million and offsetting gain of \$3 million. On PS' 2006 tax return, PS includes the section 165 loss and the corresponding gain. PS must disclose the transaction under this section because PS' section 165 loss of \$12 million is equal to or greater than \$2 million. P is allocated \$9.6 million of the section 165 loss and \$2.4 million of the offsetting gain. P does not have to disclose the transaction under this section because P's section 165 loss of \$9.6 million is not equal to or greater than \$10 million. S is allocated \$2.4 million of the section 165 loss and \$600,000 of the offsetting gain. S must disclose the transaction under this section because S's section 165 loss of \$2.4 million is equal to or greater than \$2 million.

(4) Substantially similar. The term substantially similar includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar must be broadly construed in favor of disclosure. For example, a transaction may be substantially similar to a listed transaction even though it involves different entities or uses different Code provisions. (See e.g., Notice 2003-54, 2003-2 C.B. 363, describing a transaction substantially similar to the transactions in Notice 2002-50, 2002-2 C.B. 98, and Notice 2002-65, 2002-2 C.B. 690.) The following examples illustrate situations where a transaction is the same as or substantially similar to a listed transaction under paragraph (b)(2) of this section. (Such transactions may also be reportable transactions under paragraphs (b)(3) through (7) of this section.) The following examples illustrate the provisions of this paragraph (c)(4):

Example 1. Notice 2000-44 (2000-2 C.B. 255) (see ' 601.601(d)(2) of this chapter), sets forth a listed transaction involving offsetting options transferred to a partnership where the taxpayer claims basis in the partnership for the cost of the purchased options but does not adjust basis under section 752 as a result of the partnership's assumption of the taxpayer's obligation with respect to the options. Transactions using short sales, futures, derivatives or any other type of offsetting obligations to inflate basis in a partnership interest would be the same as or substantially similar to the transaction described in Notice 2000-44. Moreover, use of the inflated basis in the partnership interest to diminish gain that would otherwise be recognized on the transfer of a partnership asset would also be the same as or substantially similar to the transaction described in Notice 2000-44.

Example 2. Notice 2001-16 (2001-1 C.B. 730) (see ' 601.601(d)(2) of this chapter), sets forth a listed transaction involving a seller (X) who desires to sell stock of a corporation (T), an intermediary corporation (M), and a buyer (Y) who desires to purchase the assets

(and not the stock) of T. M agrees to facilitate the sale to prevent the recognition of the gain that T would otherwise report. Notice 2001-16 describes M as a member of a consolidated group that has a loss within the group or as a party not subject to tax. Transactions utilizing different intermediaries to prevent the recognition of gain would be the same as or substantially similar to the transaction described in Notice 2001-16. An example is a transaction in which M is a corporation that does not file a consolidated return but which buys T stock, liquidates T, sells assets of T to Y, and offsets the gain recognized on the sale of those assets with currently generated losses.

(5) Tax. For purposes of this section, the term tax means Federal income tax.

(6) Tax benefit. A tax benefit includes deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, status as an entity exempt from Federal income taxation, and any other tax consequences that may reduce a taxpayer's Federal income tax liability by affecting the amount, timing, character, or source of any item of income, gain, expense, loss, or credit.

(7) Tax return. For purposes of this section, the term tax return means a Federal income tax return and a Federal information return.

(8) Tax treatment. The tax treatment of a transaction is the purported or claimed Federal income tax treatment of the transaction.

(9) Tax structure. The tax structure of a transaction is any fact that may be relevant to understanding the purported or claimed Federal income tax treatment of the transaction.

(d) Form and content of disclosure statement. A taxpayer required to file a disclosure statement under this section must file a completed Form 8886, "Reportable Transaction Disclosure Statement" (or a successor form), in accordance with this paragraph (d) and the instructions to the form. The Form 8886 (or a successor form) is the disclosure statement required under this section. The form must be attached to the appropriate tax return(s) as

provided in paragraph (e) of this section. If a copy of a disclosure statement is required to be sent to the Office of Tax Shelter Analysis (OTSA) under paragraph (e) of this section, it must be sent in accordance with the instructions to the form. To be considered complete, the information provided on the form must describe the expected tax treatment and all potential tax benefits expected to result from the transaction, describe any tax result protection (as defined in §301.6111-3(c)(12) of this chapter) with respect to the transaction, and identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and the identity of all parties involved in the transaction. An incomplete Form 8886 (or a successor form) containing a statement that information will be provided upon request is not considered a complete disclosure statement. If the form is not completed in accordance with the provisions in this paragraph (d) and the instructions to the form, the taxpayer will not be considered to have complied with the disclosure requirements of this section. If a taxpayer receives one or more reportable transaction numbers for a reportable transaction, the taxpayer must include the reportable transaction number(s) on the Form 8886 (or a successor form). See §301.6111-3(d)(2) of this chapter.

(e) Time of providing disclosure--(1) In general. The disclosure statement for a reportable transaction must be attached to the taxpayer's tax return for each taxable year for which a taxpayer participates in a reportable transaction. In addition, a disclosure statement for a reportable transaction must be attached to each amended return that reflects a taxpayer's participation in a reportable transaction. A copy of the disclosure

statement must be sent to OTSA at the same time that any disclosure statement is first filed by the taxpayer pertaining to a particular reportable transaction. If a reportable transaction results in a loss which is carried back to a prior year, the disclosure statement for the reportable transaction must be attached to the taxpayer's application for tentative refund or amended tax return for that prior year. In the case of a taxpayer that is a partnership, S corporation, or trust, the disclosure statement for a reportable transaction must be attached to the partnership, S corporation, or trust's tax return for each taxable year in which the partnership, S corporation, or trust participates in the transaction under the rules of paragraph (c)(3)(i) of this section. If a taxpayer in a partnership, S corporation, or trust receives a timely Schedule K-1 less than 10 calendar days before the due date of the taxpayer's return (including extensions) and, based on receipt of the timely Schedule K-1, the taxpayer determines that the taxpayer participated in a reportable transaction within the meaning of paragraph (c)(3) of this section, the disclosure statement will not be considered late if the taxpayer discloses the reportable transaction by filing a disclosure statement with OTSA within 45 calendar days after the due date of the taxpayer's return (including extensions).

(2) Special rules--(i) Listed transactions and transactions of interest. In general, if a transaction becomes a listed transaction or a transaction of interest after the filing of a taxpayer's tax return (including an amended return) reflecting the taxpayer's participation in the listed transaction or transaction of interest and before the end of the period of limitations for assessment of tax for any taxable year in which the taxpayer participated in the listed

transaction or transaction of interest, then a disclosure statement must be filed, regardless of whether the taxpayer participated in the transaction in the year the transaction became a listed transaction or a transaction of interest, with OTSA within 60 calendar days after the date on which the transaction became a listed transaction or a transaction of interest. The Commissioner also may determine the time for disclosure of listed transactions and transactions of interest in the published guidance identifying the transaction.

(ii) Loss transactions. If a transaction becomes a loss transaction because the losses equal or exceed the threshold amounts as described in paragraph (b)(5)(i) of this section, a disclosure statement must be filed as an attachment to the taxpayer's tax return for the first taxable year in which the threshold amount is reached and to any subsequent tax return that reflects any amount of section 165 loss from the transaction.

(3) Multiple disclosures. The taxpayer must disclose the transaction in the time and manner provided for under the provisions of this section regardless of whether the taxpayer also plans to disclose the transaction under other published guidance, for example, §1.6662-3(c)(2).

(4) Example. The following example illustrates the application of this paragraph (e):

Example. In January of 2006, F, a calendar year taxpayer, enters into a transaction that at the time is not a listed transaction and is not a transaction described in any of the paragraphs (b)(3) through (7) of this section. All the tax benefits from the transaction are reported on F's 2006 tax return filed timely in April 2007. On May 1, 2009, the IRS publishes a notice identifying the transaction as a listed transaction described in paragraph (b)(2) of this section. Upon issuance of the May 1, 2009 notice, the transaction becomes a reportable transaction described in paragraph (b) of this section. The period of limitations on assessment for F's 2006 taxable year is still open. F is required to file Form 8886 for the transaction with OTSA within 60 calendar days after May 1, 2009.

(f) [The text of the proposed amendment to §1.6011-4(f)(1) is the same as the text for §1.6011-4T(f)(1) published elsewhere in this issue of the **Federal Register**].

(2) Protective disclosures. If a taxpayer is uncertain whether a transaction must be disclosed under this section, the taxpayer may disclose the transaction in accordance with the requirements of this section and comply with all the provisions of this section, and indicate on the disclosure statement that the disclosure statement is being filed on a protective basis. The IRS will not treat disclosure statements filed on a protective basis any differently than other disclosure statements filed under this section. For a protective disclosure to be effective, the taxpayer must comply with these disclosure regulations by providing to the IRS all information requested by the IRS under this section.

(g) Retention of documents. In accordance with the instructions to Form 8886 (or a successor form), the taxpayer must retain a copy of all documents and other records related to a transaction subject to disclosure under this section that are material to an understanding of the tax treatment or tax structure of the transaction. The documents must be retained until the expiration of the statute of limitations applicable to the final taxable year for which disclosure of the transaction was required under this section. (This document retention requirement is in addition to any document retention requirements that section 6001 generally imposes on the taxpayer.) The documents may include the following: marketing materials related to the transaction; written analyses used in decision-making related to the transaction; correspondence and agreements between the taxpayer and any advisor, lender, or other party to the reportable transaction that relate to the transaction;

documents discussing, referring to, or demonstrating the purported or claimed tax benefits arising from the reportable transaction; and documents, if any, referring to the business purposes for the reportable transaction. A taxpayer is not required to retain earlier drafts of a document if the taxpayer retains a copy of the final document (or, if there is no final document, the most recent draft of the document) and the final document (or most recent draft) contains all the information in the earlier drafts of the document that is material to an understanding of the purported tax treatment or tax structure of the transaction.

(h) Effective date--(1) In general. In general, this section applies to transactions entered into on or after the date these regulations are published as final regulations in the **Federal Register**. However, upon the publication of final regulations, this section will apply to transactions of interest entered into on or after November 2, 2006.

(2) [The text of the proposed amendment to §1.6011-4(h)(2) is the same as the text for §1.6011-4T(h)(2) published elsewhere in this issue of the **Federal Register**].

#### PART 20-- ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 3. The authority citation for part 20 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 4. Section 20.6011-4 is amended as follows:

1. Paragraph (a) is amended by adding the language “or a transaction of interest” after the first occurrence of “listed transaction” and by adding the language “or transaction of interest” after the second occurrence of “listed transaction”.

2. Paragraph (b) is revised.

The revision reads as follows:

§20.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.

\* \* \* \* \*

(b) Effective date. This section applies to listed transactions entered into on or after January 1, 2003. Upon the publication of final regulations, this section will apply to transactions of interest entered into on or after November 2, 2006.

PART 25--GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. The authority citation for part 25 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 6. Section 25.6011-4 is amended as follows:

1. Paragraph (a) is amended by adding the language “or a transaction of interest” after the first occurrence of “listed transaction” and by adding the language “or transaction of interest” after the second occurrence of “listed transaction”.

2. Paragraph (b) is revised.

The revision reads as follows:

§25.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.

\* \* \* \* \*

(b) Effective date. This section applies to listed transactions entered into on or after January 1, 2003. Upon the publication of final regulations, this section will apply to transactions of interest entered into on or after November 2, 2006.

PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 7. The authority citation for part 31 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 8. Section 31.6011-4 is amended as follows:

1. Paragraph (a) is amended by adding the language “or a transaction of interest” after the first occurrence of “listed transaction” and by adding the language “or transaction of interest” after the second occurrence of “listed transaction”.

2. Paragraph (b) is revised.

The revision reads as follows:

§31.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.

\* \* \* \* \*

(b) Effective date. This section applies to listed transactions entered into on or after January 1, 2003. Upon the publication of final regulations, this section will apply to transactions of interest entered into on or after November 2, 2006.

PART 53--FOUNDATION AND SIMILAR EXCISE TAXES

Par. 9. The authority citation for part 53 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 10. Section 53.6011-4 is amended as follows:

1. Paragraph (a) is amended by adding the language “or a transaction of interest” after the first occurrence of “listed transaction” and by adding the language “or transaction of interest” after the second occurrence of “listed transaction”.

2. Paragraph (b) is revised.

The revision reads as follows:

§53.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.

\* \* \* \* \*

(b) Effective date. This section applies to listed transactions entered into on or after January 1, 2003. Upon the publication of final regulations, this section will apply to transactions of interest entered into on or after November 2, 2006.

#### PART 54--PENSION EXCISE TAXES

Par. 11. The authority citation for part 54 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 12. Section 54.6011-4 is amended as follows:

1. Paragraph (a) is amended by adding the language “or a transaction of interest” after the first occurrence of “listed transaction” and by adding the language “or transaction of interest” after the second occurrence of “listed transaction”.

2. Paragraph (b) is revised.

The revision reads as follows:

§54.6011-4 Requirement of statement disclosing participation in certain transactions by

taxpayers.

\* \* \* \* \*

(b) Effective date. This section applies to listed transactions entered into on or after January 1, 2003. Upon the publication of final regulations, this section will apply to transactions of interest entered into on or after November 2, 2006.

#### PART 56--PUBLIC CHARITY EXCISE TAXES

Par. 13. The authority citation for part 56 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 14. Section 56.6011-4 is amended as follows:

1. Paragraph (a) is amended by adding the language “or a transaction of interest” after the first occurrence of “listed transaction” and by adding the language “or transaction of interest” after the second occurrence of “listed transaction”.

2. Paragraph (b) is revised.

The revision reads as follows:

§56.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.

\* \* \* \* \*

(b) Effective date. This section applies to listed transactions entered into on or after January 1, 2003. Upon the publication of final regulations, this section will apply to transactions of interest entered into on or after November 2, 2006.

Mark E. Matthews

Deputy Commissioner for Services and Enforcement.