

CC-2006-006

November 22, 2005

Subject: Examples Relating to Third Party Tax Information in Tax Shelter Matters
Cancel Date: Upon incorporation into CCDM

I. Purpose

This Notice provides examples in Q&A format that illustrate the principles set forth in Chief Counsel Notice [CC-2006-003](#) (October 25, 2005), Disclosure of Third Party Tax Information in Tax Shelter Matters.

II. Discussion

Question 1: What is an administrative proceeding pertaining to tax administration within the meaning of section 6103(h)(4)?

Answer 1: For purposes of section 6103(h)(4), administrative tax proceedings include every process within the Internal Revenue Service, including Chief Counsel's Office, designed to resolve taxpayer issues arising under the Code. This includes, but is not limited to, all measures and procedures undertaken in connection with taxpayers' examinations, appeals, collection proceedings, and ruling requests. Audits and examinations are administrative tax proceedings within the meaning of section 6103(h)(4). See *Abelein v. United States*, 323 F.3d 1210 (9th Cir. 2003) (TEFRA audit is an administrative proceeding pursuant to section 6103(h)(4)(B) or (C)); *First Western Government Securities, Inc. v. United States*, 796 F.2d 356 (10th Cir. 1986) (investor/promoter audits are administrative proceedings pertaining to tax administration); *Duquette v. IRS*, 110 F. Supp. 2d 16 (D.D.C. 2000) (audit is an administrative proceeding pertaining to tax administration). But see *Mallas v. United States*, 993 F.2d 1111 (4th Cir. 1993) (audit is not an administrative proceeding pertaining to tax administration).

Question 2: What is a judicial proceeding pertaining to tax administration within the meaning of section 6103(h)(4)?

Answer 2: Judicial proceedings pertaining to tax administration within the meaning of section 6103(h)(4) include, for example, any action filed in the United States Tax Court, suits for tax refund filed in the United States Court of Federal Claims or the district courts, summons enforcement actions, and other lawsuits arising out of the Service's examination, collection, or other tax enforcement activities.

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Question 3. Investor A files a Tax Court petition claiming that the Service wrongfully disallowed a loss related to a transaction promoted by law firm B. In conjunction with the examination of investor A, the Service obtained promotional material and an opinion letter given by promoter B to investor A, which materials conclude that the tax consequences of the transaction have substantial authority. The promotional material also informs prospective investors of the anticipated amount of loss that is associated with various dollar amounts invested. The Service has also opened an examination on investor C with respect to a transaction that was also promoted by B and that is substantially similar to A's transaction. During investor C's examination, the Service obtained an opinion letter and promotional material issued by B to C that uses language or has other features in common with A's promotional material and opinion letter with the exception of the investors' names, addresses, and dollar amounts. C's opinion letter and promotional material tend to prove that B had a routine practice of promoting a set of transactions the purpose of which was to generate a tax loss without any economic effect to the taxpayer. May the Service disclose C's opinion letter and promotional material in A's Tax Court litigation?

Answer 3. Yes. The Tax Court litigation instituted by A is a judicial proceeding pertaining to tax administration. The promotional material and opinion letter issued by B to C is C's tax information because it was obtained by the Service in conjunction with C's examination. C's documents satisfy the item test of section 6103(h)(4)(B). The documents relate to the liability of A, not merely similarly situated third parties, because C's documents are evidence that A purchased a "cookie cutter" deal lacking a valid business purpose and thus support the basis for the proposed adjustment at issue in the Tax Court. The documents also directly relate to an element of A's claim at issue in the proceeding, e.g., C's documents provide pattern evidence that A's transaction lacked a business purpose.

Question 4. During the course of an examination of Investor D for a section 351 transaction promoted by E and executed by accommodation party F, the Service obtains documents and testimony from F pursuant to a summons, including a document that states that these section 351 transactions do not reflect economic reality and that the investors G, H and I, in addition to D, are entering into these transactions to generate a capital loss. The document produced by F tends to show that the transactions that E promoted and F participated in as an accommodating party – which are similar to D's, G's, H's and I's transactions – lacked economic substance. Can the document produced by F be disclosed in a refund suit filed by investor G, a taxpayer who invested in a transaction promoted by E and accommodated by F, and whose transaction was substantially similar to that of investor D's?

Answer 4. Yes. G's refund suit is a judicial proceeding pertaining to tax administration. The document produced by F is D's tax information because it was obtained by the Service in conjunction with the determination of D's tax liability. D's document satisfies the item test of section 6103(h)(4)(B). The document relates to the liability of G, not merely similarly situated third parties. The document evidences the lack of economic substance of the section 351 transactions promoted by E and accommodated by F, including G's transaction. Also, the document directly relates to an element of G's claim at issue in the proceeding, i.e., the capital loss.

Question 5. In 2000, taxpayer H enters into a listed transaction as defined in Treas. Reg. § 1.6011-4(b)(2). During investor H's examination, the Service obtains from H a fact-sheet issued by co-promoter/bank I to co-promoter/law firm J. This fact-sheet describes in detail the types of entities and transactions that will be used to effectuate H's transactions and the losses for years 1998 through 2000, and contains a fee schedule that includes both a payment to J for

J's legal opinion and a fee to J for monitoring these transactions (J's fee is based on the percentage of losses incurred by investors). The document shows that H knew that law firm J is not a disinterested party because of J's planned continuing involvement with respect to the transaction after J issued its opinion letter to H, and that investor H may not rely on J's opinion letter to avoid penalties under section 6662.

Subsequently, as part of a section 6700 examination of J, the Service issues an Information Document Request for documents relating to any transaction marketed by J, or any substantially similar transactions. In response, J forwards information relating to 33 taxpayers, including copies of the fact-sheet relating to 30 taxpayers.

The Service is also examining investor K, in conjunction with a 1999 transaction, which is substantially similar to the transaction entered into by H, and co-promoted by I and J. During K's examination, the Service obtains the opinion letter issued by J to K, but is unable to obtain the fact-sheet described above setting forth details of the transactions and the fees paid to J. May the Service disclose the fact-sheet obtained during H's examination to K?

Answer 5. Yes. K's examination is an administrative proceeding pertaining to tax administration. The document issued by co-promoter I detailing the transactions and fee schedule is H's tax information because it was obtained by the Service in conjunction with H's examination. H's fact-sheet satisfies the item test of section 6103(h)(4)(B). The document relates to the liability of K, not merely similarly situated third parties. The fees paid to J reflected on the schedule pertain not only to H's transaction, but to various transactions that were substantially similar to H's and that were promoted by I and J. The document directly relates to an element of K's claim at issue in the proceeding, e.g., that K may avoid accuracy-related penalties by relying on J's opinion letter as a disinterested party with respect to losses from a listed transaction claimed on K's return.

Question 6. During a summons enforcement action against investor L, L asserts attorney-client privilege for the opinion letter issued to L by promoter/law firm M in conjunction with a Son of Boss transaction. During the examination of taxpayer N, who invested in a Son of Boss transaction that was promoted by M and that was substantially similar to L's transaction, the Service obtained an e-mail issued by M that revealed that M routinely disclosed its opinion letters to co-promoters responsible for executing the transactions. May the e-mail be disclosed in L's summons enforcement action?

Answer 6. Yes. L's summons enforcement action is a judicial proceeding pertaining to tax administration. The e-mail issued by M is N's tax information because it was obtained by the Service in conjunction with N's examination. The e-mail satisfies the item test of section 6103(h)(4)(B). The e-mail relates to the liability of L, not merely similarly situated third parties. The e-mail provides evidence that the opinion letter was disclosed to third parties. The e-mail directly relates to an element of L's claim at issue in the proceeding, e.g., whether L may assert attorney-client privilege for the opinion letter.

Question 7: The Service is beginning an examination of Promoter F under section 6708 for penalties relating to investor lists required to be maintained with respect to three separate tax shelter transactions with investors C, D, and E. May F's examination team disclose investor C's, D's and E's tax information related to the respective transactions in the soft letter (section 6112 letter) issued to F?

Answer 7: Yes. Promoter F's examination is an administrative proceeding pertaining to

tax administration. Investor C's, D's, and E's tax information related to the investments in the respective shelter transactions meets the transaction test under section 6103(h)(4)(C) with regard to each investor's transaction with F who is being examined. Investors entered into transactional relationships with the promoter when the investors purchased interests in tax shelters organized and marketed by the promoter. Tax information regarding the transaction between the investors and F directly affects the outcome of the examination of the promoter, in which potential penalties relating to the transactions are the focus of the proceedings. Accordingly, the investor C's, D's and E's tax information may be included in the soft letter issued to F.

Question 8. During an examination of Employer T, the Service obtains documents in connection with T's deduction for payments to a trust arrangement (the Plan) that is purportedly a welfare benefit fund described in section 419A(f)(6). The documents consist of generic promotional materials, the Plan trust agreement, an opinion letter, T's enrollment package, individual insurance contracts purchased by the trust, and transactional and accounting records for the Plan and trust. These documents demonstrate the operations of the Plan and how T and other employers interact with the Plan. These documents demonstrate that the individual employers do not share the economic risk of their participation in the Plan, and consequently the Plan fails to satisfy the section 419A(f)(6) exception to the section 419 deduction limits.

The Service is also examining S, another employer that made and deducted payments to the Plan. S's deduction also depends on the theory that the Plan satisfies the section 419A(f)(6) exception. May the Service disclose the documents obtained in T's examination to S?

Answer 8. Yes. S's examination is an administrative proceeding pertaining to tax administration. The documents are T's tax information because they were obtained by the Service in conjunction with T's examination. T's documents satisfy the transaction test of section 6103(h)(4)(C). By participating in the Plan and purporting to share economic risk, S and T have a transactional relationship. The documents pertain to the economics of the Plan, to which S and T have both made payments. The documents also directly relate to the resolution of S's claim in the proceeding, *i.e.*, T's documents provide direct evidence that employers participating in the Plan do not share economic risk, so that the Plan fails to satisfy section 419A(f)(6) and S cannot rely on that section in support of its claim that its payments to the Plan are deductible.

Question 9. The Service opens an examination of Investor O for tax year 1999 in conjunction with a listed transaction promoted by P. During O's examination, the Service obtains promotional materials given to O by P that includes a detailed description of how the listed transactions are executed and the anticipated losses to the investor. Investor Q files a Tax Court petition alleging that the Service wrongfully disallowed losses in conjunction with the same type of listed transaction promoted by promoter R that are reflected on Q's 1999 return. There is no evidence of any link between promoters P and R and there is no evidence that O's documents directly relate to an element of Q's claim. May the Service disclose in Q's suit the promotional materials obtained in O's examination?

Answer 9. No. Q's Tax Court litigation is a judicial proceeding pertaining to tax administration. The promotional materials obtained in conjunction with O's examination are O's tax information because they were obtained by the Service in conjunction with the determination of O's tax liability. O's documents satisfy neither the item test of section 6103(h)(4)(B) nor the transaction test of section 6103(h)(4)(C). Although both investors O and Q engaged in the same type of listed transaction, these transactions were marketed by different promoters and

