



Transaction Required to be Disclosed

Disclosure Obligations under Section 6011 (Part A) Reportable transaction disclosure regulations

Listed Transactions

The final regulations retain the same definition, namely, a reference to transactions that are "the same as or substantially similar to" any of the transactions specifically identified by the IRS as tax-avoidance transactions in published guidance. (See separate side-by-side for summary of transactions).

Confidential Transactions

The final regulations have modified this category to clarify that prohibited confidentiality relates to an advisor's demand that taxpayers preserve confidentiality with respect to the tax treatment or the transaction (and not, for example, the taxpayer's concerns about business issues, trade secrets, etc.). Thus, a "confidential transaction," in general, is any transaction for which "the taxpayer's disclosure of the tax treatment or the tax structure of the transaction is limited in any manner by an express or implied understanding or agreement ... whether or not such understanding or agreement is legally binding."

The final regulations clarify that this category does not apply to disclosure restrictions imposed by securities laws. The category has been modified to except certain disclosure restrictions applicable in the mergers and acquisitions context (i.e., pre-public announcement restrictions). The category also has been changed to delete the attorney-client and tax practitioner-client privileges as unnecessary. The final regulations focus on the taxpayer's ability to disclose a transaction, which is unaffected by the existence of such a privilege (e.g., the taxpayer can choose to waive the privilege); such a privilege will not result ipso facto in a reporting requirement. Finally, the final regulations revise the safe harbor presumption to permit compliance within 30 days of the first discussion (rather than requiring first-day compliance). As before, this category may be avoided by an express written authorization by every promoter or advisor that permits unlimited disclosure by the taxpayer.

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Contractual Protection

This category has been limited significantly in the final regulations. Previously, the category included tax gross-up clauses, rescission rights, insurance, and tax indemnity agreements. The final regulations focus instead solely on whether (1) the taxpayer has the right to a refund of all or a part of fees if the intended tax treatment of a transaction is not sustained, or (2) fees are contingent on the taxpayer's realization of tax benefits from the transaction.

Note: This category no longer should capture tax indemnities and gross-up clauses in routine cross-border financing arrangements

Loss Transactions

This category addresses transactions expected to result in a loss under section 165, either in a single year or multiple years, above threshold amounts. For corporations, the threshold is \$10 million in a single year or \$20 million in multiple years. In determining this threshold loss amount, section 165-type losses are included even if deducted under different Code sections, such as section 741 (partnership interest) or section 988 (foreign currency). Offsetting gains or income may not be taken into account.

Rev. Proc. 2003-24 excludes certain transactions from this category, including those where the taxpayer's basis in an asset is a "qualifying basis." For this purpose, a qualifying basis is a basis determined by reference to amounts paid in cash, or an exchanged basis determined under section 358 by reason of a tax-free reorganization under sections 355 or 368. Also excluded are losses resulting from mark-to-market treatment of items and hedging transactions.



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Significant Book-Tax Differences

This category reflects modifications and clarifications from prior language. In general, a transaction is deemed to have a significant book-tax difference if the tax treatment of an item or items from the transaction differs, or is expected to differ, from U.S. GAAP treatment by more than \$10 million on a gross basis (no netting) in any tax year. However, the final regulations allow a taxpayer that does not use U.S. GAAP for any reason to determine the book treatment of its items on an alternative, consistently applied basis. Affected taxpayers include SEC reporting companies and non-SEC reporting companies with more than \$250 million in gross assets. The temporary regulations had used a \$100 million asset threshold for non-reporting companies. U.S. parent companies must file disclosure statements with respect to transactions entered into by their CFCs if (i) the CFC would be considered to participate in a reportable transaction (other than a transaction with a significant book/tax difference) if it were a domestic corporation filing a U.S. tax return reflecting the items of the transaction, or the CFC participates in a transaction with a significant book tax difference, and (ii) the transaction reduces or eliminates an income inclusion under section 551 (foreign personal holding companies), 951 (subpart F), or 1293 (PFIC).

Note: The changes made in the final regulations have done little to reduce the complexity or burdens resulting from application of the regulations to CFCs.

Responding to extensive comments on the proposed regulations, the IRS increased from 13 to 30 the categories of excluded transactions. Moreover, as with exceptions from the section 165 book loss rules, the IRS listed these exclusions not in regulations but in Rev. Proc. 2003-25. Excluded transactions now include:

- Items to the extent a book loss or expense is reported before or without a loss or deduction for Federal income tax purposes (or tax income or gain without book income or gain);
- Depreciation, depletion under section 612, and amortization relating solely to differences in methods, lives (for example, useful lives, recovery periods), or conventions, percentage depletion under sections 613 or 613A, and intangible drilling costs under section 263(c);
- Capitalization and amortization under sections 195, 248, and 709;
- Certain mark-to-market transactions including FAS 133 derivatives;
- Bad debts and cancellation-of-indebtedness income;
- Certain securitization transactions;
- Certain hedging transactions;



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- Dividends (including any dividends received deductions), amounts treated as dividends under section 78, and income inclusions under the anti-deferral regimes of sections 551, 951, and 1293;
- Items resulting from the application of the nonrecognition rules of sections 354, 355, 361, 367, 368, and 1031 (but not section 1032), if the taxpayer complies with the applicable filing and reporting requirements; and
- Life insurance reserves determined under section 897 and non-life insurance reserves under section 832(b), and capitalization of policy acquisition expenses of insurance companies.

Brief Asset Holding Period

This category includes transactions involving assets giving rise to a tax credit in excess of \$250,000, including a foreign tax credit, that are held (or deemed held under section 246(c)(3) and (c)(4)) for 45 days or less.

Record Keeping Requirements

The final regulations have modified the record retention requirements, but a qualification in the rule applicable to retention of draft documents could limit significantly the apparent benefit of the modifications.

The final regulations require taxpayers to "retain a copy of all documents and other records related to a transaction subject to disclosure ... that are material to an understanding of the tax treatment or tax structure of the transaction." The list of documents subject to retention requirements is broad, and includes "documents discussing, referring to, or demonstrating the purported tax benefits," as well as documents "referring to the business purposes for the reportable transaction."

Note: The final regulations appear to relax the retention requirement applicable to drafts, so long as final documents are retained. However, drafts must be retained unless the final document 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." This qualification is inherently ambiguous, and it is not yet clear whether and to what extent taxpayer burdens under the record retention requirements are relaxed in practice.

The documents and records that must be retained are to be retained for an extraordinary period – "until the expiration of the statute of limitations applicable to the final taxable year for which disclosure of the transaction was required...."



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Timing and Manner of Disclosure

Disclosure must be made on the tax return for each year in which the taxpayer participates in a reportable transaction, with a copy to the Office of Tax Shelter Analysis for the first year. When a transaction that otherwise was not disclosed becomes a listed transaction subsequent to the filing of a final return affected by the transaction (and prior to the expiration of the statute of limitations with respect to that return), the transaction must be reported on first return filed after the listing -- whether or not that return is affected -- and a copy filed with OTSA. The regulations provide that the disclosure must be made on Form 8886 ("Reportable Transaction Disclosure Form"); to date, that form has been released only as draft.

The final regulations retain the ability to make "protective disclosures." In addition, the final regulations have retained provisions for taxpayers to obtain a ruling as to whether their transaction is reportable. Formal disclosure of the ruling is suspended while the IRS is considering the ruling. New language appears to authorize the IRS to issue rulings, in its discretion, that exempt a particular transaction or a "type" of transaction. Thus, a taxpayer with a transaction that is exempt from disclosure can request the IRS to issue a prospective ruling exempting all similar transactions in the future from disclosure. In addition, taxpayers that submit a transaction for a ruling on its merits can be exempted from disclosure.

Effective Dates

The revised disclosure regime set forth in October 2002 generally applies to all transactions entered into on or after January 1, 2003. While the final regulations must be applied to all transactions entered into on or after February 28, 2003, taxpayers also may elect to analyze transactions entered into on or after January 1, 2003 and before February 28, 2003 under either the October 2002 or the final regulations. The final regulations clarify that the February 28, 2000 regulations, as amended, apply to transactions entered into before January 1, 2003.

Note: The final regulations generally appear more taxpayer-favorable than the October 2002 temporary regulations in terms of which transactions must be disclosed. In addition, the record retention requirements under the final regulations appear somewhat less onerous than the earlier requirements. Thus, most affected taxpayers are expected to rely on the final regulations for transactions entered into on or after January 1, 2003, and forego reliance on the earlier temporary regulations for transactions between January 1, 2003 and February 28, 2003.