



Committee On Finance

Max Baucus, Ranking Member

NEWS RELEASE

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Baucus Seeks to End the Use of Abusive Tax Shelters

Senator Introduces Legislation to Crack Down on Unethical and Illegal Tax Shelters

(WASHINGTON, D.C.) U.S. Senator Max Baucus today took action to put to an end, once and for all, the use of illegal tax shelters similar to those employed by Enron and numerous other companies by introducing the Tax Shelter Transparency and Enforcement Act. Senate Finance Committee Chairman Chuck Grassley (R-Iowa) joined Baucus in introducing the legislation.

"It has been over two years since the collapse of Enron, and corporate scandals are still rampant," Baucus said. "Over the past year, I have included this tax shelter legislation within a number of separate bills, and am now introducing it as a stand-alone bill in the hopes of achieving passage once Congress returns in January. It is inexcusable that Congress has not passed a single piece of tax shelter legislation to shut down these abusive tax practices."

Baucus's bill takes a number of steps to eliminate tax shelters, including ensuring that transactions are done for legitimate business purposes, have economic substance, and are not merely to avoid taxes. Also, high penalties will be imposed against those who do not comply with the U.S. Treasury's new shelter disclosure requirements.

In addition, the bill broadens the Internal Revenue Service's ability to enjoin tax shelter promoters and allows the agency to impose monetary penalties — in addition to suspension or disbarment — on disreputable tax advisors or their firms.

"Tax shelters are not fair to the corporations and taxpayers who strive to comply with the law," said Baucus. "We need to work on restoring faith in our tax system. Every day we fail to address abusive tax shelter practices, honest taxpayers pay the bill. The legislation Chairman Grassley and I introduced today will help combat abusive tax avoidance transactions."

The Senator acknowledged that some have questioned whether codification of the economic substance doctrine is the most efficient method of combating abusive tax shelters.

"There may be other proposals that should be examined to see if they can better shut down transactions without economic substance. I intend to work with Senator Grassley on alternative and additional proposals in the coming months," Baucus said.

Last month, the Finance Committee held one in a series of hearings on tax shelters, specifically focusing on the abusive practice of companies that "buy" and then lease out American public infrastructure such as bridges, dams, and subway systems through corporate tax shelters.

"I look forward to continuing to work together with Chairman Grassley to enact strong and meaningful tax shelter legislation early next year," Baucus added. "I urge all of my

congressional colleagues – in the House and the Senate – to join forces and send tax shelter legislation to the President for his signature. It is time to shut down these tax shelters and restore professional ethics. Congress cannot ignore this problem any longer."

Full provisions of bill follow:

**DESCRIPTION OF PROVISIONS OF
THE TAX SHELTER TRANSPARENCY AND ENFORCEMENT ACT**

TITLE I—PROVISIONS DESIGNED TO CURTAIL TAX SHELTERS

- Sec. 101 Clarification of economic substance doctrine** – Clarifies and enhances application of the economic substance doctrine. If a court determines that the economic substance doctrine applies to a transaction, the transaction must both: (1) change the taxpayer’s economic position in a meaningful way, and (2) be a reasonable means of achieving a substantial non-tax purpose.
- Sec. 102 Penalty for failing to disclose reportable transaction** – Creates new penalty for failure to include adequate information about a reportable transaction in any return or statement. Penalty is applied in addition to any accuracy-related penalty and is applied whether or not there is an understatement.
- Sec. 103 Accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose** – Provides strict-liability accuracy-related penalty for listed transactions and reportable transactions with a significant tax-avoidance purpose. The penalty is less severe if transaction is properly disclosed and can be avoided by satisfying a strengthened “reasonable cause exception.”
- Sec. 104 Penalty for understatements attributable to transactions lacking economic substance, etc.** – Provides 40% strict-liability penalty for understatements with respect to transactions with no economic substance; penalty is reduced to 20% if there is adequate disclosure.
- Sec. 105 Modifications of substantial understatement penalty for nonreportable transactions** – Strengthens definition of “substantial understatement” for purposes of applying penalty. Penalty applies if the amount of the understatement for the taxable year exceeds the lesser of (1) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, \$10,000), or (2) \$10 million.
- Sec. 106 Tax shelter exception to confidentiality privileges relating to taxpayer communications** – Provides that confidentiality privileges that apply to communications between taxpayers and “federally authorized tax practitioners” do not apply with respect to a tax shelter transaction.
- Sec. 107 Disclosure of reportable transactions** – Replaces present-law rules for tax shelter registration with clearer set of rules for disclosing information with respect to “reportable transactions.” Strengthens rules requiring material advisors to maintain lists of tax-shelter investors.

- Sec. 108** Modifications to penalty for failure to register tax shelters – **Modifies rules applicable to “material advisors” with respect to the proper disclosure of reportable transactions.**
- Sec. 109** **Modification of penalty for failure to maintain lists of investors** –Increases the penalty for failure to properly maintain lists of tax-shelter investors.
- Sec. 110** **Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions** – Provides that an injunction may be sought against a material advisor to enjoin the advisor from (1) failing to file an information return with respect to a reportable transaction, or (2) failing to maintain, or to timely furnish upon written request by the Secretary, a list of investors with respect to each reportable transaction.
- Sec. 111** **Understatement of taxpayer’s liability by income tax return preparer** – Raises the standard tax return preparers must meet to avoid penalty.
- Sec. 112** **Penalty on failure to report interests in foreign financial accounts** – Provides a new civil penalty (up to \$5000) for failure to report interests in foreign financial accounts.
- Sec. 113** **Frivolous tax submissions** – Increases the penalty for frivolous arguments and strengthens IRS’s ability to effectively deal with tactics meant to delay or impede tax administration.
- Sec. 114** **Regulation of individuals practicing before the Department of Treasury** – Gives the Secretary authority to censure or impose monetary penalties upon tax advisors (present law only includes a right to regulate, suspend or disbar practitioners).
- Sec. 115** **Penalty on promoters of tax shelters** – Increases penalty on promoters of tax shelters from a maximum of \$1000 to 50% of the promoter’s gross income with respect to the tax shelter.
- Sec. 116** **Statute of limitations for taxable years for which required listed transactions not reported** – Extends statute of limitations with respect to listed transactions if there is a failure to disclose such transactions. Statute of limitations does not begin to run until there is adequate disclosure.
- Sec. 117** **Denial of deduction for interest on underpayments attributable to nondisclosed reportable and noneconomic substance transactions** – Provides that taxpayers may not deduct interest paid to the government on underpayments of tax with respect to nondisclosed reportable and noneconomic substance transactions.
- Sec. 118** **Authorization of appropriations for tax law enforcement** -- The provision includes an authorization of an additional \$300 million to the Internal Revenue Service to be used to combat abusive tax avoidance transactions.

TITLE II—OTHER CORPORATE GOVERNANCE PROVISIONS

- Sec. 201 Affirmation of consolidated return regulation authority** – Confirms Treasury’s authority to write regulations treating corporations filing consolidated returns differently from corporations filing separate returns.
- Sec. 202 Signing of corporate tax returns by chief executive officer**– Requires that the chief executive officer of a corporation sign a declaration under penalties of perjury that the corporation’s income tax return complies with the Internal Revenue Code and that the CEO was provided reasonable assurance of the accuracy of all material aspects of the return.
- Sec. 203 Denial of deduction for certain fines, penalties, and other amounts** – Generally provides that amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government in relation to the violation of any law or the governmental investigation or inquiry into the potential violation of any law are nondeductible under any provision of the income tax provisions.
- Sec. 204 Disallowance of deduction for punitive damages** – Denies any deduction for punitive damages that are paid or incurred by the taxpayer as a result of a judgment or in settlement of a claim.
- Sec. 205 Increase in criminal monetary penalty limitation for the underpayment or overpayment of tax due to fraud** – Increases the criminal penalty limitations for tax fraud.

TITLE III—ENRON-RELATED TAX SHELTER PROVISIONS

- Sec. 301 Limitation on transfer or importation of built-in losses** – Prevents taxpayers from importing built-in losses into the U.S. in tax-free reorganizations. Basis of built-in loss property is instead increased to fair market value.
- Sec. 302 No reduction of basis under section 734 in stock held by partnership in corporate partner** – Where a partnership owns stock in one of its partners (or a related person) and is required to adjust the basis of its assets under section 734, the provision prevents a reduction to the basis of the stock of the partner (or related person).
- Sec. 303 Repeal of special rules for FASITs** – Repeals special rule for FASITs (financial asset securitization trusts), which, under current law, are untaxed at the entity level (the income is taxed to the owner of the FASIT).
- Sec. 304 Expanded disallowance of deduction for interest on convertible debt** – Expands disallowance of deduction for interest on convertible debt. Interest on convertible debt or debt that is otherwise linked to equity in an entity is not deductible, even if the underlying equity represents less than a 50% ownership interest in the entity.
- Sec. 305 Expanded authority to disallow tax benefits under section 269** – Expands section 269 by repealing the requirement that the acquisition of property be from a corporation not controlled by the acquirer.

Sec. 306 Modification of interaction between subpart F and passive foreign investment company rules – Adds an exception to section 1297(e) for U.S. shareholders that face only a remote likelihood of incurring subpart F inclusion in the event that a controlled foreign corporation earns subpart F income, thus preserving the potential application of the passive foreign investment company rules in such cases.

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