

Multistate Tax Commission

Model Statute on Disclosure of Reportable Transactions

As Adopted by the Commission September 7, 2006

I. Definitions.

1. Reportable Transaction. "Reportable transaction" means any transaction or arrangement with respect to which information is required to be included with a state return or statement because, as determined under regulations prescribed pursuant to this act, such transaction or arrangement is of a type which 1) the Director determines as having a potential for avoidance or evasion of the tax imposed by the [State income tax Act], whether through deduction or credit, the excludability or omission of any income, the manipulation of any allocation or apportionment rule, or the securing of any other tax benefit, and 2) is carried out through or invested in by at least one entity or person that is organized in this State, doing business in this State, deriving income from sources in this State, subject to [State Income Tax Act], or is otherwise subject to the jurisdiction of this State. A reportable transaction includes, but is not limited to, any transaction or arrangement described in U.S. Treasury Regulations Section 1.6011-4(b), a listed transaction as defined under Section I.2. and a non-economic substance transaction as defined under Section I.3. A "reportable transaction" does not include any transaction identified by the Director through notice, regulation, bulletin or other form of official Department guidance, as not constituting a tax avoidance transaction.

2. Listed Transaction. "Listed transaction" means a reportable transaction that is the same as, or substantially similar to, a transaction or arrangement specifically identified by the Director as a tax avoidance transaction through notice, regulation, bulletin or other form of official Department guidance. In addition, the term "listed transaction" includes any reportable transaction that is the same as, or substantially similar to, a transaction or arrangement specifically identified by the U.S. Secretary of Treasury as a tax avoidance transaction for purposes of Internal Revenue Code Section 6011.

3. Non-Economic Substance Transaction. "Non-economic substance transaction" means any transaction or arrangement that lacks economic substance, as defined by [State or federal] law; including a transaction or arrangement in which an entity is disregarded as lacking a valid nontax [State] business purpose.

4. Tax Shelter. "Tax shelter" means a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of [State] or Federal income tax.

5. Disqualified Opinion. "Disqualified opinion" means an opinion that:

A. is based on unreasonable factual or legal assumptions (including assumptions as to future events);

B. unreasonably relies on representations, statements, findings, or agreements of the taxpayer or any other person;

C. does not identify and consider all relevant facts, or

D. fails to meet any other requirement as prescribed by either the U.S. Secretary of the Treasury for purposes of Internal Revenue Code Section 6664(d)(3)(B)(iii) or the Director.

6. Disqualified Tax Advisor. “Disqualified tax advisor” means a tax advisor that meets any of the following conditions:

A. is a material advisor and participates in the organization, management, promotion, or sale of the transaction or is related (within the meaning of Internal Revenue Code Sections 267(b) or 707(b)(1)) to any person who so participates;

B. is compensated directly or indirectly by a material advisor with respect to the transaction;

C. has a fee arrangement with respect to the transaction which is contingent on all or part of the intended tax benefits from the transaction being sustained; or

D. as determined under regulations prescribed by either the Secretary of the Treasury for purposes of Internal Revenue Code Section 6664(d)(3)(B)(ii) or the Director, has a disqualifying financial interest with respect to the transaction.

7. Material Advisor. “Material advisor” means any person who:

A. provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and

B. directly or indirectly derives gross income in excess of the threshold amount (or such other amount as may be prescribed by the U.S. Secretary of Treasury for purposes of Internal Revenue Code Section 6111(b)(1)(A)) for such advice or assistance. For purposes of this section, the threshold amount is

i. \$50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons, and

ii. \$250,000 in any other case.

8. Gross Valuation Overstatement. “Gross Valuation Overstatement” means any statement as to the value of any property or services if:

A. the value so stated exceeds 200 percent of the amount determined to be the correct valuation, and

B. the value of such property or services is directly related to the amount of any deduction allowable under [State] or federal income tax, or credit allowable under [State] income tax, to any participant.

II. Taxpayer Responsibility for Disclosure of Reportable Transactions; Penalties; Waiver; Extension of Statute of Limitations.

1. Disclosure of Reportable Transactions Required.

A. Disclosure Required. For each tax year in which a taxpayer, a member of a federal consolidated group of which a taxpayer is a member[, or a member of a combined group of which a taxpayer is a member,] has participated in a reportable transaction, including a listed transaction, such taxpayer is required to disclose such transaction as provided in Section II.1. B., below. In addition, for each tax year in which a taxpayer, a member of a federal consolidated group of which a taxpayer is a member[, or a member of a combined group of which a taxpayer is a member,] is required to make a disclosure statement under Treasury Regulations Section 1.6011-4 with respect to a reportable transaction, including a listed transaction, in which the taxpayer participated; such taxpayer shall file a copy of such disclosure with the Department as provided in Section II.1.B., below.

B. Time and Manner of Disclosure. Reportable transactions, including listed transactions, shall be disclosed in the manner prescribed in Treasury regulations Section 1.6011-4 and Department rules and regulations. With respect to a federal listed transaction entered into after February 28, 2000, but before December 31, [year Act is adopted], disclosure shall be made on or before the due date of, and attached to, the taxpayer's original and any amended [State] income tax return for tax year [the year of this Act] and to the original and any amended [State] income tax return for any later tax year which reflects a reduction in tax resulting from such listed transaction, including a loss, deduction or credit resulting from a reportable transaction which is being carried forward or back. With respect to a reportable transaction, including a state or federal listed transaction, entered into after December 31, [year Act is adopted], disclosure shall be attached to the taxpayer's original and any amended [State] income tax return for the tax year during which the transaction was entered into and to the original and any amended [State] income tax return for any later tax year which reflects a reduction in tax resulting from such reportable or listed transaction, including a loss, deduction or credit which is being carried forward or back and which resulted from such transaction. Disclosure of a reportable transaction entered into after February 28, 2000 shall also be attached to any amended [State] income tax return filed after December 31, [year Act is adopted] where such filing reflects a determination by the Internal Revenue Service of the federal tax treatment of a reportable transaction.

C. Effective Date. The provisions of this Section II.1. shall apply to any reportable transaction entered into after February 28, 2000, for any tax year or years for which the transaction remains undisclosed, and for which the statute of limitations on assessment, taking into account the extension provided under Section II.4., has not expired as of 60 days after the effective date of this Act.

2. Penalties Related to Failure to Disclose a Reportable Transaction.

A. Imposition and Amount.

i. Any person who fails to include on any return or statement any information with respect to a reportable transaction which is required under Section II.1. to be included with such return or statement shall pay a penalty, in

addition to any other penalty imposed, in the amount determined under Section II.2.A.ii., below.

ii. (a) Except as provided in Section II.2.A.ii.(b), below, the amount of the penalty imposed under Section II.2.A.i., above, shall be [\$X (\$10,000 in IRC). In setting this amount, states should be cognizant that penalty may apply in other states for the same infraction.] in the case of a natural person, and [\$X (\$50,000 in IRC) Note: penalty may apply in other states for the same infraction.] in any other case.

(b) The amount of penalty under Section II.2.A.i. with respect to a listed transaction shall be [\$X (\$100,000 in IRC) Note: penalty may apply in other states for the same infraction.] in the case of a natural person, and [\$X (\$200,000 in IRC) Note: penalty may apply in other states for the same infraction.] in any other case.

B. Assessment Date. Penalty imposed under Section II.2.A.i. shall be deemed assessed on the due date of the [State] income tax return upon or attached to which disclosure of the reportable transaction was required pursuant to Section II.1. of this Act and Department rules and regulations.

C. Waiver.

i. The Director, in his or her sole discretion, may waive or abate all or any portion of any penalty imposed by this Section II.2. with respect to any violation if:

(a) the violation is with respect to a reportable transaction other than a listed transaction, and

(b) rescinding the penalty would promote compliance with the requirements of [State Income Tax Act] and effective tax administration.

ii. Notwithstanding any other law or rule of law, any determination under this Section II.2.C. may not be reviewed in any judicial proceeding.

D. Effective Date. Penalty imposed under this Section II.2. shall apply to any failure to disclose any listed transaction entered into after February 28, 2000, or any other reportable transaction entered into after the effective date of this act, as required by Section II.1., for any tax year or years for which the transaction remains undisclosed, and for which the statute of limitations on assessment, taking into account the extension provided under Section II.4., has not expired as of 60 days after the effective date of this Act.

3. Penalties Related to Understatement of Tax Resulting from a Reportable Transaction.

A. Understatement Penalty.

i. Imposition and Amount.

(a) If a taxpayer has a reportable transaction understatement for any taxable year, there shall be added to the tax an amount equal to 20 percent of the amount of such understatement.

(b) For purposes of this Section II.3.A.,

(1) The term “reportable transaction understatement” means the sum of:

(A) product of:

(i) the highest rate of tax imposed by [Section on state corporate income tax rates]; and

(ii) the amount of the increase (if any) in [State] taxable income which results from a difference between the proper tax treatment of an item to which Section II.1.A. applies and the taxpayer’s treatment of such item as shown on the taxpayer’s return of tax, including an amended return provided such amended return is filed prior to the date the taxpayer is first contacted by the Department regarding the examination of the tax year for which such amended return is filed; The amount of the increase in [State] taxable income for a particular tax year includes the restatement for another tax year to which a loss or deduction is carried forward or carried back that is attributable to the reportable transaction for that year in which the carry forward or carry back of the loss or deduction applies; and

(B) the amount of the decrease (if any) in the aggregate amount of credits which results from a difference between the taxpayers treatment of an item to which this section applies (as shown on the taxpayer’s return of tax) and the proper tax treatment of such item.

For purposes of Section II.3.A.i.(b)(1)(A), any reduction of the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would be allowed for such year, shall be treated as an increase in taxable income.

(2) This Section II.3.A. shall apply to any item which is attributable to:

(A) any listed transaction, and

(B) any reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of federal or [State] income tax.

(c) Section II.3.A.i.(a), above, shall be applied by substituting “30 percent” for “20 percent” with respect to the portion of any reportable transaction understatement with respect to which the requirements of section II.1 are not met.

(d) Except as provided in regulations, in no event shall any tax treatment included with an amendment or supplement to a return of tax be taken into account in determining the amount of any reportable transaction understatement if amendment or supplement is filed after the earlier of the date the taxpayer is first contacted by the Director regarding the examination of the return or such other date as is specified by the Director.

ii. Assessment Date. Penalty imposed under this Section II.3.A. shall be deemed assessed on the due date of the [State] income tax return which shows the understatement of tax resulting from a reportable transaction to which such penalty relates.

B. Interest Penalty.

i. 50% Interest Penalty Prior to Contact; Imposition and Amount.

For any amended return filed after [end of voluntary compliance or date of enactment if no voluntary compliance program] and before the taxpayer is contacted by the Internal Revenue Service or the Department regarding a reportable transaction, there shall be added to any reportable transaction understatement, as determined under Section II.3.A.i.(b)(1), a penalty, in addition to any other applicable penalties, equal to 50% of the interest assessed under Section [Interest Section] on such reportable transaction understatement for the period beginning on the last date prescribed by law for the payment of such tax (determined without regard to extensions) and ending on the date of payment.

ii. 100% Interest Penalty After Contact; Imposition and Amount. If the taxpayer has been contacted by the Internal Revenue Service or the Department regarding a reportable transaction, there shall be added to any reportable transaction understatement, as determined under Section II.3.A.i.(b)(1), a penalty, in addition to any other applicable penalties, equal to 100% of the interest assessed under Section [Interest Section] on such reportable transaction understatement for the period beginning on the last date prescribed by law for the payment of such tax (determined without regard to extensions) and ending on the date of the notice of proposed assessment is mailed.

iii. Assessment Date. Penalty imposed under this Section II.3.B. shall be deemed assessed upon the assessment of the interest by which such penalty is calculated and shall be collected and paid in the same manner as such interest.

C. Waiver.

i. Except as provided in Section II.3.C.ii. below, the Director, in his or her sole discretion, may waive or abate all or any portion of any penalty imposed by Section II. 3. with respect to any portion of a reportable transaction understatement if it is shown that the taxpayer had reasonable cause for such portion and acted in good faith with respect to such portion. Notwithstanding any other law or rule of law, any determination by the Director under this subdivision may not be reviewed in any judicial proceeding.

ii. Section II.3.C.i. shall not apply to any reportable transaction understatement unless:

(a) the relevant facts affecting the tax treatment of the item are adequately disclosed in accordance with all requirements of Section II.1. and Department rules and regulations. A taxpayer failing to fully disclose shall be treated as meeting the requirements of this Section II.3.C.ii.(a) if the penalty for that failure to disclose was waived pursuant to Section II.2.C.;

(b) there is or was substantial authority for such treatment; and

(c) the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. A taxpayer shall be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief:

(1) is based on the facts and law that exist at the time the return which includes such tax treatment is filed, and

(2) relates solely to the taxpayer's chances of success on the merits of such treatment and does not take into account the possibility that a return will not be audited, such treatment will not be raised on audit, or such treatment will be resolved through settlement if it is raised; and

(3) does not rely upon the opinion of a disqualified tax advisor or on a disqualified opinion.

D. Effective Date. Penalty imposed under Section II.3. shall apply to any understatement of tax resulting from a listed transaction entered into after February 28, 2000, or from any other reportable transaction enter into after the effective date of this act, in any tax year or years for which the statute of limitations on assessment, taking into account the extension provided under Section II.4., has not expired as of the effective date of this Act.

4. Extension of Statute of Limitations for Assessments Associated with Non-Disclosure of a Reportable Transaction.

If a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction as required under Section II.1., the time for assessment of any tax imposed by [State Income Tax Act] with respect to such transaction shall not expire before the date which is 1 year after the earlier of (A) the date on which the Director is furnished the information so required, or (B) the date that a taxpayer meets the requirements of Section III.2. with respect to a request by the Director under Section III.2.B. relating to such transaction with respect to such taxpayer.

III. Material Advisor Responsibility for Disclosure of Reportable Transactions and Maintenance of Advisee Lists; Penalties; Waiver.

1. Material Advisor Responsibility for Disclosure of Reportable Transactions.

A. Each material advisor with respect to any reportable transaction shall make a return in such form as the Director may prescribe setting forth -

i. information identifying and describing the transaction,

- ii. information describing any potential tax benefits expected to result from the transaction, and
- iii. such other information as the Director may prescribe.

In addition, each material advisor who is required to disclose a reportable transaction pursuant to Internal Revenue Code Section 6111 shall file a copy of such disclosure with the Department. Such return and disclosure shall be filed not later than the date specified by the Director.

B. The Director may prescribe regulations which provide -

- i. that only 1 person shall be required to meet the requirements of Section III.1.A. in cases in which 2 or more persons would otherwise be required to meet such requirements, and.
- ii. exemptions from the requirements of this section.

2. Material Advisor Responsibility for Maintenance of Reportable Transaction Advisee List.

A. Each material advisor with respect to any reportable transaction shall, whether or not required to file a return under Section III.1., maintain a list identifying each [State] taxpayer[, member of a combined group of a [State] taxpayer] and member of a consolidated return of a [State] taxpayer with respect to whom such advisor acted as a material advisor with respect to such transaction. The list required under this Section III.2.A. shall include the same information, and shall be maintained in the same form and manner, as required under Internal Revenue Code Section 6112, Treasury Regulations Section 301.6112-1, and any additional information or maintenance requirements as the Director may by regulation require.

B. Any person required to maintain a list under Section III.2.A. -

- i. shall make such list available to the Director upon written request by the Director, and
- ii. except as otherwise provided by the Director by regulation, shall retain any information which is required to be included on such list for 7 years.

C. The Director may, by regulation, provide that in cases in which 2 or more persons are required under Section III.2.A. to maintain the same list (or portion thereof), only 1 person shall be required to maintain such list (or portion).

3. Penalty for Failure to Disclose a Reportable Transaction or to Maintain Advisee List.

A. Imposition and Amount.

i. Penalty for Failure to Disclose a Reportable Transaction.

(a) If a person who is required to file a return or disclosure under Section III.1 with respect to any reportable transaction (1) fails to file such return or disclosure on or before the date prescribed therefore, or (2) files false or incomplete information with the Director with respect to such

transaction, such person shall pay a penalty with respect to such return or disclosure in the amount determined under Section III.3.A.(b) and (c).

(b) Except as provided in Section III.3.A.i.(c), below, the penalty imposed under Section III.3.A.i.(a) with respect to any failure shall be [\$X (\$50,000 under IRC)].

(c) The penalty imposed under Section III.3.A.i. with respect to any listed transaction shall be an amount equal to the greater of (1) [\$X (\$200,000 under IRC) Note: penalty may apply in other states for the same infraction.], or (2) [X% (50% under IRC) Note: penalty may apply in other states for the same infraction.]of the gross income derived by such person with respect to aid, assistance, or advice which is provided with respect to the listed transaction before the date the return and, if applicable, disclosure is filed under Section III.1. Section III.3.A.i.(c)(2) shall be applied by substituting “[Y% (75 % under IRC) Note: penalty may apply in other states for the same infraction.]” for “[X% (50 % under IRC)]” in the case of an intentional failure or act described in Section III.3.A.i.(a).

ii. Penalty for Failure to Maintain Advisee Lists. If any person who is required to maintain a list under Section III.2. fails to make such list available upon written request to the Director in accordance with Section III.2.B. within 20 business days after the date of such request, such person shall pay a penalty of [\$X (\$10,000 under IRC)] for each day of such failure after such 20th day.

iii. Each of the penalties imposed by Section III.3.A. is in addition to any other applicable penalties.

B. Waiver.

i. The Director, in his or her sole discretion, may waive all or any portion of penalty imposed under this Section III.3:

(a) with respect to any violation of Section III.1. if:

(1) the violation is with respect to a reportable transaction other than a listed transaction, and

(2) waiver of the penalty would promote compliance with the requirements of [State Income Tax Act] and effective tax administration.

(b) with respect to any violation of Section III.2 if on any day such violation is due to reasonable cause

ii. Notwithstanding any other law or rule of law, any determination by the Director under this Section III.3.B. may not be reviewed in any judicial proceeding.

4. Effective Date.

A. The provisions of this Section III. shall apply to reportable transactions, other than listed transactions, with respect to which material aid, assistance, or advice referred to in section I.7. is provided after the date of the enactment of this Act.

B. The provisions of this Section III. shall apply to listed transactions with respect to which material aid, assistance, or advice referred to in section I.7 is provided and which were entered into on or after December 31, 2001, that

- become listed transactions at any time. Reporting required under section III.1 and 2. shall be furnished to the Director on or before the later of:
- i.** 60 days after entering into the transaction;
 - ii.** 60 days after the transaction becomes a listed transaction; or
 - iii.** the effective date of this act.

IV. Tax Shelters

1. Penalty for Promotion of Tax Shelters.

A. Imposition and Amount. Any person who

- i.**
 - (a)** organizes or assists in the organization of
 - (1)** a partnership or other entity,
 - (2)** any investment plan or arrangement, or
 - (3)** any other plan or arrangement, or
 - (b)** participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement referred to in Section IV.1.A.i.(a) and
- ii.** makes or furnishes or causes another person to make or furnish in connection with such organization or sale -
 - (a)** a statement with respect to the allowability of any deduction or credit, the excludability of any income, the manipulation of any allocation or apportionment rule, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or
 - (b)** a gross valuation overstatement as to any material matter,shall pay, with respect to each activity described in Section IV.1.A.i.(a) and in addition to any other penalty provided by law, a penalty equal to the [\$X (\$1,000 under IRC) Note: penalty may apply in other states for the same infraction.] or, if the person establishes that it is lesser, [X% (100% under the IRC) Note: penalty may apply in other states for the same infraction.] of the gross income derived or to be derived by such person from such activity. For purposes of the preceding sentence, activities described in Section IV.1.A.i.(a) with respect to each entity or arrangement shall be treated as a separate activity and participation in each sale described in Section IV.1.A.i.(b) shall be so treated.

Notwithstanding the first sentence, if an activity with respect to which a penalty imposed under this subsection involves a statement described in Section IV.1.A.ii.(a), the amount of the penalty shall be equal to [X% (50 % under the IRC) Note: penalty may apply in other states for the same infraction.] of the gross income derived or to be derived from such activity by the person on which the penalty is imposed.

B. Waiver. The Director, in his or her sole discretion, may waive all or any part of the penalty provided by Section IV.A. with respect to any gross valuation overstatement on a showing that there was a reasonable basis for the valuation and that such valuation was made in good faith. Notwithstanding any other law or rule of law, any determination by the Director under this Section IV.1.B. may not be reviewed in any judicial proceeding.

2. Tax Shelter Exception to Confidentiality Privileges Relating to Taxpayer Communications. No privilege of confidentiality shall apply to any written communication which is:

A. between a tax practitioner and

i. any person,

ii. any director, officer, employee, agent, or representative of the person,

or

iii. any other person holding a capital or profits interest in the person; and

B. in connection with the promotion of the direct or indirect participation of the person in any tax shelter.

3. Effective Date. The provisions of this Section IV. shall apply to activities after the date of the enactment of this Act.

V. Injunction of Certain Conduct Related to Reportable Transactions and Tax Shelters.

1. Authority to Seek Injunction. A civil action in the name of the State to enjoin any person from further engaging in specified conduct may be commenced at the request of the Director. Any action under this Section V. shall be brought in [State District Court, county of DOR] The court may exercise its jurisdiction over such action separate and apart from any other action brought by the State against such person.

2. Adjudication and Decree. In any action under Section V., if the court finds

A. that the person has engaged in any specified conduct, and

B. that injunctive relief is appropriate to prevent recurrence of such conduct; the court may enjoin such person from engaging in such conduct or in any other activity subject to penalty under this Act.

3. Specified Conduct. For purposes of this Section V., the term “specified conduct” means any action, or failure to take action, which is

A. subject to penalty under this Act, or

B. in violation of any requirement under regulations issued pursuant to this Act.