



MULTISTATE TAX COMMISSION

**Final Report of the Hearing Officer
Regarding Proposed Model Statutes for
Reportable Transactions & State Filing Positions
And a Related
Voluntary Compliance Program
May 2006**

I. Introduction

On June 16, 2005, the Multistate Tax Commission (MTC) Executive Committee approved for public hearing an MTC proposed model statutes for Reportable Transactions & Inconsistent Filing Positions and a related Voluntary Compliance Program. The appointed hearing officer held the public hearing and received six sets of written comments. A Preliminary Hearing Officer's Report was issued November 3, 2005. Two additional sets of comments were received. This Final Hearing Officer's Report summarizes the proposals' procedural background, key substantive features and public comments; and recommends adoption of the proposals with amendments.

II. Procedural Summary

A. Development of the Proposal

In June of 2003, the Commission approved its Report entitled *Federalism at Risk*. In that Report, the Commission made several recommendations to "help restore the equity and effectiveness of state income tax systems."¹ One of those recommendations was that the states should "[s]trengthen and expand cooperative administration and enforcement among the states through early review of tax shelters considered questionable by several states..."²

In July of 2004, the MTC State Tax Compliance Initiative Steering Committee proposed to the MTC Executive Committee that an MTC model statute on Reportable

¹ *Federalism at Risk, A Report by the Multistate Tax Commission*; p. 25 (June, 2003)

² *Federalism at Risk, A Report by the Multistate Tax Commission*; p. 26 (June, 2003)

Transactions & Inconsistent Filing Positions be developed. This recommendation was based on an extensive business income tax sheltering study by the MTC Corporate Income Tax Sheltering Work Group. The Work Group was comprised of 23 state tax agency representatives representing 13 different states.³ In its report, the Work Group noted:

The marketing and employment of tax sheltering devices and strategies has increased dramatically over the last several years. Many of these devices are of questionable validity. The tax revenues involved are so significant that the Internal Revenue Service has established a list of questionable transactions and has received enforcement tools aimed at the promoters of these devices and strategies. For virtually every state, devices and strategies that impact federal tax collections also have an impact on state collections.⁴

To address this problem, the Work Group recommended:

The states, through a multistate process, could define "multistate listed transactions" that are subject to reporting and disclosure under state law. Transactions could be reportable either to individual states or to a multistate clearinghouse. Reportable "transaction" could include federal listed transactions or transactions or reporting defined by the states, that have a potential for tax avoidance ... In order to participate in this process, states would need to enact legislation that allows for the designation of listed transactions. To ensure that transactions are reported, states would need to include penalties on promoters or taxpayers for not reporting listed transactions.⁵

And in addition, the Work Group addressed reporting of state filing positions:

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Michael Mason, *Alabama*
Tamara Harris, *Arizona*
Walter Anger, *Arkansas*
Danny Walker, *Arkansas*
Michael Brownell, *California FTB*
Caglar Caglayan, *California FTB*
Ben Miller, *California FTB*
Ben Jablow, *Florida*
Lynn Chenoweth, *Idaho*
Gary Gear, *Idaho*
Dick McFarland, *Idaho*
Ted Spangler, *Idaho*

Jennifer Hays, *Kentucky*
Michael Fatale, *Massachusetts*
Alan LeBovidge, *Massachusetts*
Shona McHugh, *Montana*
Brian Staley, *Montana*
Lennie Collins, *North Carolina*
Mary Loftsgard, *North Dakota*
Janielle Lipscomb, *Oregon*
Eric Smith, *Oregon*
John Mintken, *New Hampshire*
Chuck Redfern, *New Hampshire*

⁴ *Corporate Income Tax Sheltering Work Group Report*; Prepared for the State Tax Compliance Initiative Steering Committee; p. 13 (June 17, 2004).

⁵ *Corporate Income Tax Sheltering Work Group Report*; Prepared for the State Tax Compliance Initiative Steering Committee; p. 22 (June 17, 2004).

Reporting could also be required from taxpayers on income reporting characteristics, such as income tax nexus, definition of business and non-business income, and apportionment factors by state ...

State statutes or regulations could contain a requirement that a taxpayer disclose when it files its returns that it has taken an inconsistent position with respect to the treatment of an item on a return filed with another State that has similar laws...

State tax statutes could contain a requirement that corporate taxpayers account for their reporting of income to all States in conjunction with the filing of their tax return. The spreadsheet would allow a state to compare a taxpayer's filing position in their state with the filing position taking in a sister state with comparable laws. It could be shared amongst the states to ensure that taxpayers have correctly disclosed their filing positions. A proposal for a federal requirement for a 51-jurisdiction spreadsheet was made by the Worldwide Unitary Taxation Working Group in 1984...

Without penalties or presumptions as a consequence of a failure to provide required information the requirement is more likely to be ignored. For example, if a state determined that inconsistent filing positions had been taken in filing returns with itself and a sister state it would be able to assert a presumption that the filing position in the other state would be correct in the circumstances where it would result in a greater tax for itself. The ability to assert penalties or apply presumptions would establish consequences to this requirement and would achieve greater compliance with it.⁶

The Work Group also noted the efficacy of an amnesty period associated with new provisions addressing inconsistent filing positions and reportable tax avoidance transactions:

This [Amnesty] strategy provides taxpayers with the opportunity to correct prior inconsistent filing positions whether inadvertent or purposeful. It would need to be coupled with the imposition of penalties for failure to report inconsistent filing positions in order to provide for an incentive for taxpayers to take advantage of amnesty. The current California Voluntary Compliance Initiative ... is a successful example of a state income tax amnesty. This initiative provides investors an opportunity to come forward and amend their returns, backing out any tax avoidance transactions to avoid new and enhanced penalties.⁷

⁶ *Corporate Income Tax Sheltering Work Group Report*; Prepared for the State Tax Compliance Initiative Steering Committee; p. 20 -22 (June 17, 2004).

⁷ *Corporate Income Tax Sheltering Work Group Report*; Prepared for the State Tax Compliance Initiative Steering Committee; p. 20 (June 17, 2004).

In July of 2004, the MTC Executive Committee adopted these recommendations of the MTC State Tax Compliance Initiative Steering Committee and directed that a model Reportable Transaction and Inconsistent Filing Position Statute be developed. A group of knowledgeable state tax agency representatives from states with experience and interest in this area was formed to create an initial draft statute for Uniformity Committee review.⁸ The drafting group determined two statutes should be developed – one to impose disclosure requirements for reportable transactions and state filing positions, and the other to authorize a companion voluntary compliance program. The drafting group submitted a draft voluntary compliance program statute and two alternative draft reportable transactions and state filing positions statutes for Income and Franchise Tax Uniformity Subcommittee review at the MTC’s March, 2005 meeting in Tampa, Florida. The difference between the two alternative reportable transaction and state filing position statutes was that one would require reporting of any inconsistent filing positions, and the other would require reporting of certain state filing positions, regardless of inconsistency, in the manner of a “51 state spreadsheet.”

On June 2, 2005, after review of the proposed statutes at its in-person meetings and via teleconference, the Income & Franchise Tax Uniformity Subcommittee discussed the draft statutes and voted to recommend the reportable transaction and inconsistent filing position statute and the companion voluntary compliance program statute favorably to the Uniformity Committee. On June 14, 2005, the Uniformity Committee considered the recommendation of the Subcommittee and voted to recommend the proposals favorably to the Executive Committee. On June 16, 2005, the Executive Committee approved the proposals for public hearings. Also on June 16, 2005, the Executive Committee considered a proposal from Montana to amend the proposed statute by including a nexus disclosure requirement. The Committee determined it would not amend the proposed statute at that time, but would treat the Montana proposal as an early filed public comment, for consideration at Public Hearing.

B. Public Hearings

After more than 30 days notice, a Public Hearing was held September 27, 2005 in Washington, D.C. Oral public comments were received. In addition, six sets of written comments were received. A Preliminary Hearing Officer’s Report was issued on November 3, 2005. The Preliminary Report explained that public comment was not yet complete, as three extensions of time to file comments had been granted. Preliminary hearing officer recommendations were offered based on the written comments that had been received to date. The Preliminary Report also recommended that once all the written comments were received and any additional recommendations for amendment made, the proposal with the Hearing Officer’s recommended amendments be submitted to the Uniformity Committee for its comment. Two additional sets of written testimony

⁸ Members of the drafting group included Ben Miller (CA-FTB), Caglar Caglayan (CA-FTB), Debbie Petersen (CA-FTB), Michael Brownell (CA-FTB), Deb Mayer (IL), Paul Caselton (IL), Frank Hales (UT), Lynn Solarsyk (UT) and Leonore Heavey (LA).

were received on November 22 and November 26. Written comments are provided as Exhibits:

Exhibit A	Montana Department of Revenue - Proposal for Nexus Disclosure
Exhibit B	McDermott, Will & Emery (MW&E) – Kimberley Reeder and Margaret Wilson
Exhibit C	Southerland, Asbill & Brennan (SAB) – Kendall L. Houghton, Jeffrey A. Friedman and Todd Lard
Exhibit D	Tax Executives Institute – Comments on Draft Model Statute
Exhibit E	Tax Executives Institute – Comments on Montana Proposal
Exhibit F	Uniformity Committee – Comments on Montana Proposal
Exhibit G	Montana Department of Revenue – Comments on Draft Model Statute
Exhibit H	American Institute of Certified Public Accountants (AICPA)

The Uniformity Committee reviewed the Hearing Officer’s recommended amendments at its meeting in Nashville, Tennessee on March 14, 2006, and members expressed support.

III. Summary of Substantive Provisions

A. Model Reportable Transactions & Inconsistent Filing Position Statute

This model statute has two main purposes. The first is to promote corporate income tax compliance, and the second is to do so in as uniform a manner as possible. The proposal addresses the first purpose, compliance, in two ways: 1) by requiring taxpayers and material advisors to disclose reportable transactions and 2) by requiring taxpayers to disclose inconsistent filing positions. Penalties are imposed for failures to disclose. The proposal promotes its second purpose, uniformity, by following the existing federal law on reportable transactions⁹ as closely as possible, with modifications where necessary to reflect that this rule will apply in the context of a state, rather than the federal, tax system. In addition to the federal government, eight states¹⁰ have instituted programs and/or on-going requirements for the disclosure of reportable transactions. Adoption of this proposed statute will promote uniformity by creating a model for the several other states that are contemplating similar legislation. In fact, at least three states have already introduced legislation based on this model in its draft form. The legislation has already been enacted in one of those states, Utah.

1. Definitions – Section I

⁹ See primarily IRC §§ 6011, 6111, 6112, 6501(c), 6662, 6662A, 6664(d), 6700, 6707, 6707A, 6708 and 7525.

¹⁰ The states include California, Connecticut, Illinois, Minnesota, New Jersey, New York, South Carolina and Utah.

Section I provides definitions of key terms. One of the most important terms is “reportable transaction.” In essence, a “reportable transaction” is a transaction or arrangement which the director determines has the potential for avoidance or evasion of tax. The proposed definition follows the federal definition, with the exception that it allows the Director to require reporting of transactions affecting state taxation as well as federal, and expressly identifies two types of reportable transactions - “non-economic substance transactions” and “tax shelters.” It also limits the reporting requirement to only those transactions engaged in by entities that have nexus with the state.

Another important definition is that for “listed transactions.” In essence, a listed transaction is a type of reportable transaction. It is a reportable transaction that has been specifically identified either in federal regulations as a federal listed transaction or by the state tax director in an informational bulletin as a tax avoidance transaction. This definition is also from federal law, with the exception that the reference to the federal treasury secretary is changed to reference the state tax director.

2. Taxpayer Responsibilities to Disclose – Sections II and III

The next two sections, II and III, set out the taxpayer’s disclosure responsibilities and penalties for failure to meet them. Section II addresses the taxpayer’s responsibility to disclose reportable transactions. There are three penalty provisions associated with a failure to disclose a reportable transaction: 1) a flat penalty for each failure to disclose a reportable transaction, 2) a penalty equal to 20% of any tax understatement resulting from one specific type of reportable transaction - a listed transaction, and 3) a penalty equal to 50% or 100% of the interest due on such listed transaction understatement, depending on whether the taxpayer had been contacted by the department or came forward voluntarily. The first two penalties, for failure to disclose and for understatement, are from federal law. The third penalty, the interest penalty, is from California law. Under the proposal, the director has authority to waive each of these penalties. The waiver provisions are directly from federal law with the following exceptions. First, the Director’s discretion not to waive penalty may not be reviewed in any administrative or judicial proceeding. This provision follows the California law. Federal law allows review in administrative, but not judicial, proceedings. Second, for some types of waivers, the federal version states that no penalty may be imposed if there is reasonable cause, but the state version is changed to read that the director may waive penalty if there is reasonable cause. In addition to penalties, if a taxpayer fails to disclose a listed transaction, the statute of limitations for assessment of tax with respect to that listed transaction is extended, as under federal law. The proposal extends the statute of limitations until one year after the information is received.

Section III sets out taxpayers’ responsibility to disclose inconsistent state filing positions. An “inconsistent filing position” essentially means the reporting of information on a return in one state in a manner that is inconsistent with how the same information is reported on a return in another state. Of course, there is no counterpart to this section in federal law. The taxpayer is also required to retain records related to the inconsistency, and to provide those records to the director within 30 days of a request.

The section imposes penalties for failure to disclose, provide or retain information regarding an inconsistent filing position. As with reportable transactions, the statute of limitations is extended if there is a failure to disclose. In addition, the taxpayer's burden of proof is increased, to clear and convincing evidence, with respect to any underpayment resulting from an inconsistent filing position.

3. Material Advisor Responsibilities to Disclose – Section IV

A “material advisor” is any person who promotes a reportable transaction and who, by doing so, receives gross income in excess of a threshold amount. Under the proposal, material advisors would be required to disclose their promotion of reportable transactions and to retain an “advisee list.” These provisions are directly from federal law, with the exception of substituting the term “Director” for “Treasury Secretary.” Penalties, subject to waiver by the Director, would apply for failure to disclose or to retain an advisee list.

4. Tax Shelters – Section V

Under the proposal, any person who organizes a tax shelter and knowingly furnishes a false statement of opinion as to a material tax aspect of the transaction, or who issues a “gross valuation overstatement” is subject to penalties. A “tax shelter” is defined as any entity or plan that has a significant purpose of tax evasion. Penalties resulting from a gross valuation overstatement may be waived by the director if there was a reasonable basis for the valuation and it was made in good faith. These provisions are all from federal law.

5. Other Enforcement Provisions – Section VI.

Section VI provides authority for the director to seek an injunction against any conduct that is subject to penalty under the proposed statute or associated regulations.

B. Model Voluntary Compliance Program

This proposal would establish a model uniform Voluntary Compliance Program which a state could implement as a companion statute to the Reportable Transactions and Inconsistent Filing Positions statute. Under the proposal, a taxpayer who has participated in a “tax avoidance transaction” (which includes, but is not limited to, a reportable or listed transaction) would be eligible for certain penalty waivers if it files an amended return for each tax year affected by the transaction and makes full payment of the tax due. The amended return must be specific to the tax avoidance transaction and may not include other unrelated adjustments which offset the amount of tax due. Any other adjustments could still be made by separate amended return.

Under this proposal, the taxpayer may elect to comply with or without appeal. If the taxpayer elects to comply without appeal, all penalties applicable to the underreporting of tax due to the tax avoidance transaction are waived. If the taxpayer elects to comply with appeal, the penalties specifically imposed on reportable or listed

transactions would be waived, but the regular underpayment penalties would still be applicable.

IV. Public Comment and Hearing Officer Recommendations

The public hearing for this proposal was well attended and significant useful public comments were received. Exhibit I shows the hearing officer's recommendations for amendment in light of public comments. Most of the recommendations are simple changes that would improve the existing provisions. Some are more on the order of technical clean-up. However, one recommendation would be fairly comprehensive and is in response to extensive public comment expressing concern regarding the requirement that a taxpayer disclose inconsistent filing positions taken in different states. The recommendation is to eliminate this requirement altogether, and substitute a much less burdensome requirement that a taxpayer simply report what it filed in each state for certain key items – a “51 state spreadsheet.” The state auditors, rather than taxpayers, will then be responsible for identifying any inconsistencies and for determining their significance, or lack thereof.

A. Proposed Changes to the Model Statute for Disclosure of Reportable Transactions and Inconsistent Filing Positions

1. Definition of Reportable and Listed Transactions

The definition of “reportable transaction” in the proposed statute is from federal law, with the exception that it allows the Director to require reporting of transactions affecting state taxation as well as federal, and expressly identifies two types of reportable transactions - “non-economic substance transactions” and “tax shelters.” Several commenters suggested changes to this definition as discussed below.

Tax Shelters

The elimination of “tax shelter” from the definition of reportable transaction was recommended by some commenters to increase uniformity with the federal law, eliminate undue burdens on taxpayers and enhance workability of the proposal. (TEI –RT, p. 7; SAB, p. 9; AICPA, p.9) The hearing officer agrees with this recommendation. The definition of “tax shelter” involves fraudulent statements and valuations, rather than specific types of transactions. For *disclosure* purposes, the focus of the requirement should be on the type of *transaction* required to be disclosed, rather than the truth of statements or valuations associated with the transaction. A separate penalty for participation in a tax shelter remains in the proposal, parallel to federal law.

Non-economic Substance Transactions

Although “non-economic substance transactions” are not explicitly mentioned in the federal statute, the MTC proposed model statute does identify these transactions as reportable transactions which must be disclosed. Some commenters cautioned that

crafting workable statutory language which adequately delineates economic substance is close to impossible. (AICPA, p. 9) Others point out that there is no one definition of this term, and suggest that codification by statute would be unwise (SAB p. 9).

Although efforts to codify the doctrine are taking place at the federal level, and in 2005 a definition was passed by the U.S. Senate¹¹, the MTC proposed model statute does not attempt to codify a definition of this judicial doctrine.¹² Rather, the proposed model statute simply refers to “economic substance as defined by state or federal law,” and requires that transactions which meet those applicable standards be disclosed. At this point, these definitions are primarily judicial, established through case law. At some time in the future the standards may be more commonly codified in state and/or federal statute. But the reasonable concerns that “codification might hinder valid business transactions and possibly [constrain] the courts’ ability to apply the doctrine to situations not covered by the statute” (TEI - RT, p. 7), are not raised by the MTC proposal.¹³

Moreover, the rationale supporting judicial application of the economic substance doctrine applies just as strongly, if not more so, in support of administrative disclosure requirements. Where a transaction’s form meets the literal requirements of the tax statute, but there is not economic substance, the legislative intent in establishing the tax benefit prescribed for that form of transaction is almost certainly not fulfilled. These are precisely the type of transactions tax administrators need to become aware of so that they may approach the legislature with proposals for statutory clarification, provide regulatory guidance or seek the determination of the courts.

¹¹ See S. 2020, introduced 11/16/05 and passed the Senate 11/18/05. See also HR 4370 and S. 2045, both introduced 11/17/05.

¹² The U.S. Supreme Court articulated this doctrine in *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978):

[W]here ... there is a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the parties.

Id. At 583-584.

In following this guidance from the Supreme Court, the federal Courts of Appeals have varied somewhat in their application of these concepts as tests (See discussion in *Black & Decker Corp. v. United States* No. 05-1015, (February 2, 2006), but the tests generally take into account 1) an objective determination as to whether there are any economic effects of the transaction beyond the creation of tax benefits, and 2) a subjective determination as to whether there was any motivation, or business purpose, of the taxpayer in entering the transaction beyond the creation of tax benefits.

¹³ Even if the term were codified for purposes of this model statute, the purposes of the statute are only to require disclosure. Requiring disclosure is not a prohibition of any business transaction. Nor is it a restriction on the court’s ability to prohibit business transactions that weren’t required to be disclosed.

Some commenters expressed that the currently applicable judicial definitions of economic substance are too vague to serve as a basis for reporting requirements: “While the ‘reportable transaction’ and ‘listed transaction’ definitions in federal tax law certainly have points open to interpretation, such definitions are more objective and well established benchmarks for reportable transaction disclosure [than economic substance].” However, in the opinion of the hearing officer, the disclosure requirements for non-economic substance transactions are reasonably clear – in general, if a taxpayer’s motive for entering into a transaction is the tax benefit, or if the transaction has little chance of producing meaningful economic benefit beyond tax reduction, the transaction should be disclosed.

Because there is a good justification for requiring disclosure of non-economic substance transactions, and because requiring such disclosure, by itself, does not raise the concerns associated with codifying the existing judicial definitions of the term, the hearing officer does not recommend deleting the express inclusion of these transactions in the definition of reportable transaction.

State Reportable Transactions

The definition of reportable transaction in the proposed model statute closely follows the federal definition, with modifications where necessary to reflect that this will be a state, rather than a federal statute. Thus, it is the “Director” rather than the “U.S. Secretary of Treasury” who determines whether a transaction has the potential for avoidance or evasion of the state tax; and transactions affecting “... allocation or apportionment ...” may be required to be reported in addition to those affecting “...deduction or credit, the excludability or omission of any income or the securing of any other tax benefit...” Several commenters felt that deviating from the federal statutory language by allowing state Directors to determine what must be reported could lead to an unacceptable lack of uniformity across the states. The concern is that although the language of the state disclosure laws would be uniform, the implementation of those laws may not be. (SAB, p.8; TEI-RT, p.4; AICPA, p. 7; MT, p. 2)

Commenters proposed various solutions, including limiting the definition of listed and reportable transactions to those transactions that are identified as listed or reportable transactions for federal purposes (AICPA, p.9), limiting the scope of reportable transactions to specific categories with the potential to contain tax-abusive transactions (SAB, p.8), and enumerating specific considerations a state revenue director should take into account in determining whether a transaction or arrangement has a potential for state tax evasion (MT, p.2)

The hearing officer agrees that the potential for lack of uniformity in disclosure requirements is a valid concern and steps should be taken to address that concern. But the hearing officer would not recommend dropping state reportable transactions entirely. There is significant potential tax avoidance and evasion based on manipulation of state laws that have no application in the federal arena and would not be address through the federal definitions of reportable or listed transactions. Prime examples are the use of

regulated investment companies (RICs) and Real estate investment trusts (REITs) which have no undue impact at the federal level, but in the context of state taxation can be used to entirely avoid paying tax on large amounts of income.¹⁴ Another example might be the use of Intangible Holding Companies. These types of arrangements can be used to shift income from one jurisdiction to another, which would have no interest for the federal government unless the income is being shifted overseas. Several of the states that have adopted or are considering adoption of reporting rules allow for state reportable transactions.¹⁵

Other proposals to limit types of transactions that can qualify as reportable transactions have merit. But the usefulness of the model statute could be seriously impeded if such limitations were to be included in statute – which they would necessarily have to be to have the intended effect– given the speed at which new tax avoidance mechanisms are developed vs. the speed at which new legislation can be enacted and implemented. The proposal to enumerate specific considerations for determining reportable transactions appears to be a useful solution. However, the hearing officer suggests that any such enumerations should not be codified in the model statute. To bring about the uniformity that could come from enumeration, the hearing officer suggests the MTC facilitate a joint state effort to enumerate considerations (possibly, although not necessarily, as a uniform model regulation) and then to regularly identify the transactions which will be considered reportable in accordance with those considerations. The transactions could be identified through a process by which the director first posts a description of the proposed transaction, allowing it to be discussed by a committee of states, and then hopefully uniformly applied in all states.

Tax Avoidance vs. Tax Evasion

The proposed model statute regularly refers to “tax avoidance or evasion.” One commenter suggested that because “tax avoidance” has so often historically been used to describe acceptable tax planning, as distinct from “tax evasion,” the federal definitions should be incorporated by reference where possible, and where that is not possible, the term “tax avoidance” should be deleted. (MT, p.1) The commenter makes a good point, but the hearing officer would not recommend this change. While substituting a reference to federal law where possible has some strategic merit, it has no substantive effect since the federal statute includes “tax avoidance.” More problematically, in areas where a reference to federal law is not possible, deleting the term “tax avoidance” would remove the primary objective of the statute. The main purpose of the statute is not to require disclosure of tax evasion. Tax evasion is already clearly prohibited by law, and entities that are engaged in evasion are unlikely to disclose it pursuant to the requirements of this statute. The main purpose of the statute is to require the disclosure of “questionable” transactions that, although they are consistent with the letter of the statute (and thus are arguably “perfectly legal”), they are not likely to be consistent with legislative intent.

¹⁴ In fact, federal guidelines explicitly provide that these arrangements do NOT need to be identified at the federal level.

¹⁵ See AICPA, p.4; also see legislation introduced in Louisiana, Montana and Utah.

Disclosure of these arguably legal transactions allows the Department to become aware of them, so that it might seek legislative, regulatory or judicial clarification. Including transactions aimed at what might be legal tax avoidance does not make the transactions illegal; it merely requires them to be disclosed. Removing the requirement to disclose these transactions removes what is perhaps the main point and primary usefulness of the statute.

“Angel List”

Commenters also suggested an amendment to allow the director to specifically list transactions which are *not* required to be disclosed, as well as to list those that are required to be disclosed. (TEI – RT, p. 8; SAB, p.7) This ability could be an important tool for making taxpayers’ disclosure responsibilities as clear as possible. Federal law provides the IRS that authority via regulation, rather than statute. However, statutory authority would be simple to provide and could help promote uniformity across the states. Therefore, the hearing officer recommends this provision be added to the definition of “listed transaction.”

Use of Informational Bulletins

Some commenters noted that while reportable transactions must be determined by regulation, listed transactions may be identified by the Director through more informal guidance and expressed concern that this will place the determination of listed transactions outside the administrative process and prevent state tax administrators from working in partnership with taxpayers. (AICPA, p. 8) Concern was also expressed that this could make uniformity all the more difficult. (TEI, p. 4) These are reasonable points, but the use of more informal guidance for listed transactions is necessitated by the director’s need for an avenue to provide guidance on listed transactions quickly, as is done at the federal level. One commenter suggested the provision could be improved by slightly different language (TEI, p.6, point 6) and the hearing officer recommends that proposal be adopted.

Application of Federal Rules and Guidance

Concern was expressed that the statute does not prevent a state from claiming a transaction is subject to reporting even if the IRS does not do so under the same statutory language, because there is no express requirement that the taxpayer have actually treated the transaction as reportable for federal purposes and nothing in the model requires a state to adopt or to respect the administrative decisions of the IRS. (SAB, p. 7 - 8) It is not clear that the taxpayer’s treatment of a transaction should govern the state determination, and uniformity with federal regulatory provisions might best be obtained through state regulatory provisions rather than by including both federal statute and portions of federal regulations in the state statute. But even in the absence of state regulations, many states’ statutes include express direction that the states administer provisions from federal law as consistently as possible with how those similar provisions are administered at the federal level. A federal interpretation of a provision identical to state law is instructive for the

state tax administrator and the state court. And indeed the reason this model statute adheres as closely as possible to the language and format of the federal statute is precisely so as not to imply any difference between the state and federal statutory interpretations where none was intended.

2. Penalties

Multi-state Application of Penalties

Some commenters expressed concern that the existence of fixed dollar penalties for failure to disclose could quickly add up if the taxpayer or material advisor has not disclosed in several states or to the federal government. (AICPA, p. 13-14; TEI p.10) Of course everyone would recognize that a statutory requirement with no corresponding penalty for failure to comply could quickly become meaningless. So some penalty level must be set. The model statute does not propose a penalty level, rather it provides information on the amount imposed at the federal level and leaves this determination to each state. States should set penalties at a level that appropriately considers the potential for application of multi-state penalties; and, as suggested by one of the commenters (AICPA, p. 14), a bracketed note was added to bring states' attention to this issue. A suggestion was made to eliminate the interest penalties to address this concern and because they are thought unnecessary. But the interest penalties are designed to differentiate between disclosures made before vs. after a taxpayer has been contacted by the state and thereby provide an incentive for voluntary disclosure. A suggestion was also made to limit the interest penalty calculations only to the interest arising on underpayment of reportable transactions (AICPA, p. 15) – the hearing officer recommends that clarification.

Review of Director's Exercise of Discretion to Waive

One of the proposal's penalty provisions has been somewhat controversial. That is the provision that would prohibit administrative and judicial review of the Director's discretion to, for reasonable cause, waive the penalty which is otherwise properly imposed by the statute. This provision is based on California law. Federal law prohibits judicial review, but not administrative review. Commenters suggested that prohibiting administrative and judicial review of a penalty waiver determination is inappropriate. (MWE, p.4; TEI- RT, p. 8-9; AICPA pp. 14-15; MT, p. 2) One commenter suggested that lack of review would place an inordinate amount of control in the hands of the director and severely limit the due process rights of taxpayers and material advisers, and that the lack of due process would likely trigger a lack of transparency on the part of state tax administrators and impair taxpayers perceptions of how fairly the law is administered and applied. (AICPA p. 14) That commenter suggested the ability to attain review of Director's discretion for these purposes should be allowed in the same manner and to the same extent as review of any other use of discretion by the Director. (AICPA p. 15)

In light of the comments, the hearing officer recommends the provision be changed to follow federal law on this point; i.e. to restrict judicial, but not administrative,

review. (See AICPA, p.9) The recommendation is not based on due process concerns. The statute establishes disclosure requirements. If those requirements are violated, the statute applies a penalty. The question of whether or not the disclosure requirements were violated and thus a penalty applies is subject to comprehensive administrative and judicial review in accordance with due process. The additional provision for waiver is simply one of legislative grace, allowing the Director to grant a discretionary surrender of the state's right to a payment where ordinarily the taxpayer would have no legitimate claim to such relief. In many states, the Director's discretion would not be reviewable even without the express provision here.¹⁶ (See AICPA, p. 15; recommending penalty waiver determinations be made and reviewed in a manner consistent with a state's customary penalty waiver policies and procedures.) But, other state commenters have suggested that the absence of a clear statement on this point could allow or encourage attempts at yet another round of protest and costly litigation, the potential for which might justify doing away with the Director's discretion to waive altogether. In light of the above, the hearing officer sees no compelling need to go beyond the federal statute to allow, or to imply through silence the allowance of, judicial review - the allowance of administrative review should provide adequate oversight and transparency for discretionary penalty waiver determinations.

Comments were also received on other penalty related provisions. One commenter raised issues regarding the calculation of the understatement penalty (suggesting the penalty should apply to the amount of unpaid tax rather than the amount by which taxable income is understated) and the circumstances under which penalties can be waived (suggesting those circumstances are too narrow). (SAB, p. 9-10) These suggestions are reasonable. However, the statute as it is currently written closely adheres to federal law, which is also reasonable, and the suggestions must be balanced against the administrative cost of deviating from federal law. The hearing officer suggests the federal provisions are not unreasonable and recommends that the goal of uniformity with federal statutes would outweigh consideration of alternative approaches.

3. Amendments to the Inconsistent Filing Position Requirement

Extensive comments were received regarding the proposal's requirement for taxpayer disclosure of inconsistent filing positions. (TEI – RT, pp. 10-11; MWE, pp. 1-5; SAB, pp. 4-6; AICPA pp. 10-11) Commenters characterized this section of the proposal as vague, overbroad and burdensome. One commenter noted that the tax systems in the various states are not uniform to a degree that would support subjecting compliant taxpayers to the administrative burden of reviewing filings to determine inconsistencies, to penalties for failure to identify the inconsistencies, or to an increased burden of proof where there is an inconsistency. (TEI – RT, p. 11) Another commenter described a “terrible administrative burden of identifying, cataloging and disclosing its inconsistent filing positions” that “has the potential to dwarf general state tax filing responsibilities themselves.” (MW&E, p. 2) Several noted that inconsistent positions are often the result

¹⁶ See, e.g., *Chatterjee et al. v. Commissioner of Revenue Services*; SC 17354, (Conn. 4/11/06).

of inconsistent state laws. (See e.g. SAB, p. 5) All commenters suggested the removal of the section from the proposed statute.

The hearing officer agrees that the requirement to disclose inconsistent filing positions should be deleted and recommends that it be replaced with a requirement for the provision of a “51 state spreadsheet.” The “51 state spreadsheet” was an alternative recommendation of the original drafting group, based on the recommendation of the Corporate Income Tax Sheltering Work Group which was approved for development by the State Tax Compliance Initiative Steering Committee ¹⁷, and would meet most, although not all, of the concerns expressed in written testimony. The spreadsheet would allow a state to easily compare a taxpayer's filing position in their state with the filing position taken in a sister state known to have comparable laws. It could be shared among the states to ensure that taxpayers have correctly disclosed their filing positions.

In the alternative, the Hearing Officer would recommend taxpayers simply be required to maintain the desired information and provide it within 30 days of a written request.

4. Reporting for Consolidated and/or Unitary Group Members

Commenters pointed out that the model statute places a duty on a taxpayer to disclose not only its own reportable transaction, but also any reportable transaction undertaken by a member of its unitary group. (SAB, p.8; AICPA, p.9) The suggestion was made that in separate entity states the reportable transaction disclosure requirement should not include transactions participated in by members of the taxpayer's unitary group. The hearing officer agrees this would be a reasonable consideration for separate entity states adopting the proposal and recommends brackets be placed around the reference to members of a combined group to indicate that the reference should only be included where applicable. Furthermore, the hearing officer recommends that for combined reporting states the provision should be narrowed in some instances to refer to members of the taxpayers combined group, not its unitary group.

5. Addition of a Nexus Disclosure Requirement

The Montana Department of Revenue submitted a comment that the proposed statute be broadened to require disclosure of entities that solicit business in the state but not filing a return. Such entities would be required to report income and receipts attributable to the state, how business is solicited in the state, how services and products are delivered, the existence of any personnel, property or sales in the state and any other information the director may require. The Executive Committee asked that the Uniformity Committee review and comment on this nexus disclosure recommendation. Although the Uniformity Committee found the nexus disclosure proposal to be of interest, it ultimately did not recommend the proposed statute be amended to include it, citing constitutional, procedural and scope issues. These issues were also noted by

¹⁷ A proposal for a federal requirement for a 51-jurisdiction spreadsheet was made by the Worldwide Unitary Taxation Working Group in 1984.

Commenters representing taxpayers. (TEI – MP comments; AICPA p. 16-17) For these reasons, the Hearing Officer does not recommend inclusion of the nexus proposal in this proposed statute.

6. Material Advisors

Definition

The proposed model statute’s definition of “material advisor” follows the federal statute almost word for word. One commenter suggested the definition be modified to exclude all officers, directors, or employees of a taxpayer who provide advice to their employer and also to exclude external advisors who are unconnected to a promoter. (TEI, p.12) However, it is not clear that employees of the taxpayer are included, given that in order to meet the definition of material advisor a person must “derive gross income in excess of the threshold amount ...for such advice or assistance.” Arguably, the employee’s income is not directly derived specifically “for such advice or assistance.” But at any rate, there does not appear to be a reason why this definition should be different for states than it is for the federal government purposes. The hearing officer recommends the federal definition be followed.

Thresholds

Whether person meets the definition of “material advisor” depends in part on whether the gross income that person derives from a particular transaction exceeds a certain threshold amount. One commenter pointed out that the threshold amount of gross income used in the definition of material advisor may subject to modification by the Director and that this could lead to lack of uniformity across the states as to whether a particular person is a material advisor with reporting responsibilities. (MWE, p. 5) The commenter suggested removing this discretion and relying instead on the federal threshold amounts. This suggestion would allow additional uniformity among the states and federal government without unduly limiting the states ability to obtain disclosures. The hearing officer recommends it be adopted.

Material Advisor Nexus

One commenter suggested that the model does not provide standards for determining when a material advisor has a sufficient connection to a particular state to require disclosure of reportable transactions. (MWE, p.6) In fact, the model specifies the types of reportable transactions that a material advisor has the responsibility to disclose to the state – i.e. those transactions that are carried out through or invested in by at least one entity that is organized in the State, doing business in this State, deriving income from sources in the State, subject to [the State income tax act], or is otherwise subject to the jurisdiction of the State. Then, under the model, any material advisor which is subject to the jurisdiction of the state, including states jurisdiction through the state blue sky laws (laws requiring registration of securities offerings, and registration of brokers and

brokerage firms), would be required to disclose those reportable transactions that have a connection with the state.

“Greater of” Penalties

One commenter noted that the provision which subjects material advisors to penalties for failure to disclose equal to the greater of a fixed rate or “50% of the gross income derived by such person” could lead to serious compounding of penalties if multiple states adopt the provisions. (AICPA, p. 14) The 50% language is from the federal statute and the hearing officer agrees that states should not simply adopt that amount but should review and set this percentage at a level that appropriately considers the potential for multi-state penalty imposition. This provision should be handled in the same manner as the provisions setting fixed dollar penalties. The hearing officer recommends the proposal be amended so that it does not specify a percentage.

Breadth of Reporting Requirements

It was noted that concerns regarding the definition of reportable transaction also impact material advisors’ due to their responsibility to disclose those reportable transactions (SAB, p. 10). The suggested remedy is to remove the material advisor disclosure requirement in its entirety. It is true that the clarity of the definition of reportable transaction will affect both the taxpayers’ and the material advisors’ reporting burden. Rather than delete the material advisor responsibilities, the hearing officer recommends focusing on the definition of reportable transaction as discussed above.

7. Other

There were a number of other, small or technical changes suggested by commenters. These were adopted wherever possible. Those that were adopted are indicated in the Exhibit I and are not further discussed here. Some suggestions were not adopted, either because the suggestion was based on a misunderstanding of the statutory language; the language was already incorporated through reference to federal statute or regulation; the suggested language should apply to more than just reportable transactions and thus would be more appropriately and likely is already contained in other, generally applicable, state statutory provisions; or because the suggestion is more appropriately addressed through regulation rather than statute. Some suggestions would have amounted to a non-substantive improvement in the language of the statute, but were not adopted because they would cause the model statute to deviate from the federal language and possibly create an incorrect implication that a substantive difference was intended.

B. Proposed Model Statute for Tax Avoidance Transaction Voluntary Compliance Program

Only one commenter had suggestions for this proposed model statute. (AICPA, p.15-16). The first suggestion was that the statute should allow taxpayers to claim viable offsetting adjustments at the time they submit amended returns disclosing tax

understatements attributable to the use of a tax avoidance transaction. The hearing officer recommends amendment to clarify that a taxpayer is not prohibited from separately filing an otherwise permissible amended return that covers other, non-tax avoidance related issues and overstatements of tax. The second suggestion involves requiring action by the department on the taxpayer's valid refund request take place in a more timely manner. The hearing officer recommends changes to limit the time period for review to at most the term of the state's standard statute of limitations. The third point is an expression of concern that there is little guidance as to what will constitute "full cooperation" with department inquiries. The hearing officer acknowledges this aspect of the statute, but suggests not everything can be nailed down in detail in a statute, and that despite that limitation, the provision still has usefulness.

Respectfully Submitted,

Shirley K. Sicilian
Hearing Officer

Exhibit I

Multistate Tax Commission

**Draft Model Uniform Statute on
Reportable Transactions and State Filing Positions**

*Recommendations of the Hearing Officer
May 10, 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.4.

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. The Director may, through notice, regulation, bulletin or other form of official Department guidance, specifically identify transactions that are not tax avoidance transactions and are not subject to disclosure under this Act.

3. Inconsistent Filing Position. "Inconsistent filing position" means the reporting or reflecting of information on any return filed for [State] income tax purposes in a manner inconsistent with the manner in which the same or similar information was reported or reflected on any return filed by the same taxpayer, or by a member of a unitary group of which the same taxpayer is a member, in another state with respect to a tax on or measured by net income for the same tax year.

4. Non-Economic Substance Transaction. "Non-economic substance transaction" means any transaction or arrangement that lacks economic substance, as defined by [State

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or federal] law; including a transaction or arrangement in which an entity is disregarded as lacking a valid nontax [State] business purpose.

5. 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.

6. 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.

7. 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.

8. 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. Deleted: or the Director

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.

9. 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,¹ 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 federal consolidated group of which a taxpayer is a member, or a member of a unitary 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.

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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.

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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.

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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 IV.2. with respect to a request by the Director under Section IV.2.B. relating to such transaction with respect to such taxpayer.

III. Taxpayer Responsibility for Disclosure of Filing Positions; Penalties; Waiver; Extension of Statute of Limitations; Presumption and Burden of Proof.

1. Disclosure of Filing Positions in other Income Tax States.

A. Disclosure Required. A taxpayer that conducts business activity in this state and one or more other states or is a member of a combined reporting group that conducts business activity in this state and one or more other states, shall disclose, in the form and manner prescribed by the Director, the filing position taken in all other income tax states with respect to whether a filing is required, business income, nonbusiness income, apportionment, and combined reporting.

B. Definitions. For purposes of Section III of this Act:

i. "Business activity" means any activity conducted in a state that gives rise to gross income or an expense reflected in the taxpayer's federal income tax return or income tax return of any state, or the use (or availability for use) of property in the state.

ii. "State" means a state of the United States, and includes the District of Columbia.

iii. "Income tax state" means any state that imposes a tax on, according to, or measured by income.

iv. "Business income" means the total income (or loss) subject to apportionment.

v. "Nonbusiness income" means income (or loss) subject to allocation to a specific state or states.

vi. "Apportionment percentage" means the percentage formula used to assign a portion of the business income of the taxpayer or the combined reporting group of which the taxpayer is a member to an income tax state.

vii. "Apportionment factor" means any component ratio used in the apportionment percentage used to apportion business income, such as a property factor, payroll factor, or a sales factor.

viii. "Allocation" means assignment of income to one or more income tax states by means other than apportionment.

ix. "Combined reporting" means a method of determining business income and apportionment that takes into account the business income and apportionment factors of more than a single corporation, and for purposes of this section includes a consolidated return.

C. Information Required to Be Disclosed. For each income tax state in which a taxpayer or a member of a combined reporting group of which a taxpayer is a member has business activity, the following information shall be disclosed:

i. Whether the taxpayer filed in that state.

Deleted: III. Taxpayer Responsibility for Disclosure of Inconsistent Filing Positions; Penalties; Waiver; Extension of Statute of Limitations; Presumption and Burden of Proof.

1. Disclosure of Inconsistent Filing Positions.

A. Disclosure Required.

i. Any taxpayer that reports or reflects an inconsistent filing position on any original or amended [State] income tax return for any tax year shall disclose such inconsistent filing position, in the time and manner prescribed by Section III. I.B. and Department rules and regulations.

ii. Disclosure required under Section III. I.A.i. shall include, but not be limited to, the following:

(a) For any income or loss in excess of \$500,000 reported on the taxpayer's [State] return as nonbusiness (business) income or loss, a list of all states for which such income or loss was treated as business (nonbusiness) income or loss.

(b) If the members included in the taxpayer's combined report or consolidated return filed in this state differ from the members included in the combined report or consolidated return filed in another state, the taxpayer shall identify each of the other states and provide for each such state a list of members: 1) included in this state that are excluded in that state, and 2) excluded in this state that are included in that state.

(c) For any total amount of property, payroll, or sales that in the aggregate exceeds 5% of the total that is included in the denominator of such apportionment factor for this state that is not included in the numerator of the apportionment factor of this state or any other state that apportions income using the same or similar apportionment factor, a list of the amount and rationale for the exclusion.

(d) Any other inconsistent filing position and information related to such position as the Director may require by regulation.

B. Time and Manner of Disclosure.

Disclosures required by Section III. I. shall be filed within 6 months of the due date of an original [State] income tax return, and shall be filed with and attached to any amended [State] income tax return for any tax year, in the form and manner required by the Director, where such return reflects a reduction in tax resulting from an inconsistent filing position, including a reduction in tax due to a loss, deduction or credit which is being carried forward or back and which resulted from an inconsistent filing position taken in any year.

... [1]

ii. The business income of the taxpayer, or of the taxpayer's combined reporting group, reported to that state.

iii. The total nonbusiness income of the taxpayer, or the total nonbusiness income of each member of the taxpayer's combined reporting group.

iv. The total nonbusiness income of the taxpayer, or the total nonbusiness income of each member of the taxpayer's combined reporting group, allocable to that state.

v. For each of the apportionment factors used to determine the apportionment percentage, the dollar amount of the numerator and the denominator of the ratio used in that factor.

vi. The apportionment percentage used to apportion income subject to taxation in that state.

vii. The dollar amount of business income apportioned to that state.

viii. For those states that use combined reporting to apportion income, for each combined reporting group of which the taxpayer is a member, a list of all corporations whose business income was included in business income of the combined reporting group.

ix. Such other information relating to the determination of business income, nonbusiness income, or the apportionment or allocation of that income as the Director, by regulation, shall require.

D. Time and Manner of Disclosure. Disclosures required by Section III.1. shall be filed with, and attached to, the original and any amended [State] income tax returns for any tax year to which the requirements apply, in the form and manner required by the Director.

E. Effective Date. The provisions of this Section III.1. are effective for tax years ending on or after the effective date of this Act.

2. Retention and Provision of Records.

A. Retention and Provision of Records Required. A taxpayer shall retain a copy of its filings of [State] schedule [apportionment schedule identifier] and of the equivalent schedule filed by the taxpayer [or a member of the taxpayer's combined reporting group] in such other state or states in which the taxpayer [or the taxpayer's combined reporting group] conducted business activity; and shall, within 30 days of written request, or within such additional time as the Director may grant upon written request for extension, provide a copy of such schedules to the Director. Information required to be retained under this Section III.2. shall be retained for that period of time during which the taxpayers' income tax liability to this state for that tax year may be subject to adjustment, including all periods in which additional income taxes or penalties may be assessed, or during which a protest, appeal or lawsuit is pending with respect to [State] income tax, but not less than ten years from the due date or extended due date of the return.

B. Effective Date. The provisions of this Section III.2. shall apply to information associated with any return due on or after the date two years before the enactment of this Act. Provided however, during the course of an audit investigation, the Director may, following the effective date of this Act, require provision of such information as may be in possession of the taxpayer [or a member of the taxpayer's combined reporting group]for any tax year for which the statute of limitations on assessment has not expired.

3. Penalties Related to Failure to Disclose, Retain or Provide Information Regarding Filing Positions.

A. Imposition and Amount.

i. A taxpayer that fails to fully disclose, retain or provide any information with respect to filing positions as required by Section III.1 and 2. of this Act and Department rules and regulation, shall be subject to penalty in an amount determined under Section III.3.A.ii., in addition to any other applicable penalties.

ii. (a) For failure to file a disclosure of filing positions required pursuant to Section III.1., the amount of the penalty shall be the greater of \$10,000 or 0.25 percent of the amount of net income properly apportioned and allocated to this State.

(b) For failure to provide information required to be retained under Section III.2. within 30 days of a request by the Director, or within such additional time as the Director may allow by extension, there shall be assessed a penalty in the amount of \$[X]. An additional penalty in the amount of \$[Y] shall be assessed with respect to each additional 30 days thereafter during which the information is not provided. A taxpayer that has not retained the information required under Section III. 1. C., shall, after submitting an affidavit that such information does not exist, be subject to a penalty in the amount of \$[Z] in lieu of additional 30 day penalties.

B. Assessment Date. Penalty imposed under Section III.3.A.ii.(a) shall be deemed assessed on the due date of the [State] income tax return upon or attached to which disclosure of filing positions was required pursuant to Section III.1 and Department rules and regulations. The penalty imposed under Section III.3.A.ii.(b) shall be deemed assessed on the 30th day following a request by the director, and , if applicable, every 30 days thereafter for which taxpayer fails to provide the information required to be retained pursuant to Section III.2 .

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 III.3. with respect to any violation if rescinding the penalty would promote compliance with the requirements of this Act and effective tax administration.

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

D. Effective Date. Penalty imposed under this Section III.3. shall apply to any failure to disclose, retain or provide any information regarding a filing position, as required pursuant to Section III.1. or 2., with respect to any tax year ending on or after the effective date of this Act.

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

If a taxpayer fails to fully disclose all information required under Section III.1 of this Act and Department rules and regulations with respect to filing positions, an assessment and notice of deficiency may be issued not later than [twice the standard SOL] after the return or statement was due or filed, whichever is later, upon or attached to which such disclosure was required. Extension of the statute of limitations under this Section III.2. is limited to extension for purpose of assessment of a tax deficiency, penalty and interest resulting from an application of the proper tax treatment with respect to a filing position that was not disclosed and that is an inconsistent filing position as defined in Section I.3.

5. Presumption and Burden of Proof.

A taxpayer shall be presumed to be liable for any underpayment of tax properly assessed by the Director, where such underpayment resulted from a filing position, which is an inconsistent filing position, as defined in Section I.3., with respect to a position taken in another state with substantially similar law. The taxpayer may overcome such presumption by submission of clear and convincing evidence to the contrary.

IV. 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 IV.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 IV.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 IV.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.

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B. Any person required to maintain a list under Section IV.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 IV.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 IV.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 IV.3.A.(b) and (c).

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

(c) The penalty imposed under Section IV.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 IV.1. Section IV.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 IV.3.A.i.(a).

ii. Penalty for Failure to Maintain Advisee Lists. If any person who is required to maintain a list under Section IV.2. fails to make such list available upon written request to the Director in accordance with Section IV.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 IV.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 IV.3.:

(a) with respect to any violation of Section IV.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 IV.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 IV.3.B. may not be reviewed in any judicial proceeding.

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4. Effective Date.

i. The provisions of this Section IV. shall apply to reportable transactions, other than listed transactions, with respect to which material aid, assistance, or advice referred to in section I.8. is provided after the date of the enactment of this Act.

ii. The provisions of this Section IV. shall apply to listed transactions with respect to which material aid, assistance, or advice referred to in section I.8 is provided and which were entered into on or after December 31, 2001, that become listed transactions at any time. Reporting required under section IV.1 and 2. shall be furnished to the Director on or before the later of:

- (a) 60 days after entering into the transaction;
- (b) 60 days after the transaction becomes a listed transaction; or
- (c) the effective date of this act.

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V. 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 V.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 V.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 V.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 V.1.A.i.(b) shall be so treated.

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Notwithstanding the first sentence, if an activity with respect to which a penalty imposed under this subsection involves a statement described in Section V.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 V.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 V.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 V. shall apply to activities after the date of the enactment of this Act.

VI. 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 VI. 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 VI. , 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 VI., 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.

**Multistate Tax Commission
Income & Franchise Tax Uniformity Subcommittee**

**Draft Model Uniform Statute for
Tax Avoidance Transaction Voluntary Compliance Program**

*Recommendations of the Hearing Officer
May 2006*

Section 1. Definitions.

A. Eligible taxpayer. The Tax Avoidance Transaction Voluntary Compliance Program applies to any taxpayer who, during the period from [Program start date] to [Program start date plus X months], does both of the following:

i. files an amended [State] tax return for each tax year for which the taxpayer has previously filed a [State] tax return using a tax avoidance transaction to underreport the taxpayer's [State] income tax liability, reporting the total [State] net income and tax for such tax year computed without regard to any tax avoidance transactions and without regard to any other adjustments, which may be filed separately, that are unrelated to tax avoidance transactions; and

ii. makes full payment of the entire amount of [State] income tax and interest due for such tax year that is attributable to the use of the tax avoidance transaction.

B. Tax avoidance transaction. A transaction, plan or arrangement devised for the principal purpose of avoiding federal or [state] income tax. Tax avoidance transactions include but are not limited to "reportable transactions," as defined in Section I.1. of the [RT and IFP Act], including "listed transactions," as defined in Section I.2. of the [RT and IFP Disclosure Act].

Section 2. Tax Avoidance Transaction Voluntary Compliance Program.

A. In general. There is hereby established a Tax Avoidance Transaction Voluntary Compliance Program (Program) for eligible taxpayers subject to tax under the [State Income Tax Act], as provided in this Act. The Program shall be developed and administered by the Department of Revenue (Department). The Program shall be conducted from [Program start date] to [Program start date plus X months] and shall apply to tax liabilities attributable to the use of tax avoidance transactions for tax years beginning before January 1, [more than 6 months before program start date]. The Department shall adopt rules, issue forms and instructions, and take such other action as it deems necessary to implement the provisions of this Act.

B. Election. An eligible taxpayer may elect to participate in the Program with respect to any tax year to which this Act applies under either Section 2.B.i. or Section 2.B.ii. The election shall be made for all tax years for which the taxpayer will participate and a separate election for different tax years, or for different transactions in different tax years,

is not allowed. Such election shall be made in the form and manner prescribed by the Department, and, once made, shall be irrevocable.

i. Voluntary compliance without appeal. If an eligible taxpayer elects to participate under this Section 2.B.i., then:

(a) The Department shall waive or abate all penalty applicable to the underreporting or underpayment of [State] income tax attributable to the use of tax avoidance transactions for such tax years for which the taxpayer voluntarily complies, including penalty imposed under [the RT and IFP Act];

(b) except as otherwise provided in this Act, the Department shall not seek criminal prosecution against the taxpayer for such tax year, underreporting and underpayment with respect to tax avoidance transactions for which the taxpayer voluntarily complies;

(c) no penalty may be waived or abated under this Act if the penalty imposed relates to an amount of [State] income tax assessed or paid prior to [Program start date]; and

(d) the taxpayer may not file a claim for credit or refund with respect to the tax avoidance transactions for such tax year or for any amounts paid under this Act.

ii. Voluntary compliance with appeal. If an eligible taxpayer elects to participate under this Section 2.B.ii., then:

(a) the Department shall waive or abate any penalty imposed under [the RT and IFP Act] with respect to disclosure of tax avoidance transactions and underpayment of [State] income tax resulting from the use of tax avoidance transactions for any tax years for which the taxpayer voluntarily complies, but shall not waive accuracy related penalties as imposed prior to [date of enactment of RT and IFP Act];

(b) except as otherwise provided in this Act, the Department shall not seek criminal prosecution against the taxpayer for such tax year underreporting and underpayment with respect to tax avoidance transactions for which the taxpayer voluntarily complies;

(c) no penalty may be waived or abated under this Act if the penalty imposed relates to an amount of [State] income tax assessed or paid prior to [Program start date];

(d) The fact a taxpayer participated in the Program shall not be considered evidence the taxpayer engaged in a tax avoidance transaction;

(e) Any penalties which are not waived or abated shall be deemed assessed upon the due date of the return (determined without regard to extensions) upon which such amount should have been paid; and

(f) The taxpayer may file a claim for credit or refund as provided in the [State] Income Tax Act with respect to such tax year. Notwithstanding [Section on deemed denials], the taxpayer may not file [an appeal] until after either of the following:

(1) the department issues a [final determination] with respect to the transactions at issue, or

(2) the earlier of (A) the date which is 180 days after the date of a final determination by the Internal Revenue Service with respect to the transactions at issue, or (B) the date that is [X years, where X = the number of years in the State's standard SOL] after the date the claim for refund was filed or one year after full payment of all [State] income tax, including penalty and interest. Section [section on administrative deemed denials] shall not apply to claims filed under this section.

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C. Installment payment agreement. The Department may enter into an installment payment agreement in lieu of the full payment required under Section 1.A. Any installment payment agreement authorized by this subsection shall include interest on the unpaid amount at the rate prescribed by [regular interest provisions]. Failure by the taxpayer to fully comply with the terms of the installment payment agreement shall render the waiver of penalties null and void, and the total amount of tax, interest, and all penalties shall be immediately due and payable.

D. Amended returns; unpaid amounts. After [Program end date], the Department may issue a deficiency assessment upon an amended return filed pursuant to Section 1.A., impose penalties, or initiate criminal action under this part with respect to the difference between the amount shown on that return and the correct amount of tax, and the penalty relief under this Act shall not apply to any portion of the underpayment attributable to a tax avoidance transaction not paid to the State.

E. Correspondence from the Department. Any correspondence mailed by the Department to a taxpayer at the taxpayer's last known address outlining the Program established under this Act constitutes a "contact" for purposes of Sections II.3. of the [RT and IFP Act].

F. Taxpayer Cooperation. In addition to any other authority to examine returns, for the purpose of improving state tax administration, the Department may inquire into the facts and circumstances related to the use of tax avoidance transactions to underreport the tax liabilities for which a taxpayer has participated in the voluntary compliance initiative under this Act. Taxpayers shall cooperate fully with inquires described in this Section 2.F. Failure by a taxpayer to fully cooperate in an inquiry described in this Section 2.F. shall render the waiver of penalties under this Act null and void and the taxpayer may be assessed any penalties that may apply.

III. Taxpayer Responsibility for Disclosure of Inconsistent Filing Positions; Penalties; Waiver; Extension of Statute of Limitations; Presumption and Burden of Proof.

1. Disclosure of Inconsistent Filing Positions.

A. Disclosure Required.

i. Any taxpayer that reports or reflects an inconsistent filing position on any original or amended [State] income tax return for any tax year shall disclose such inconsistent filing position, in the time and manner prescribed by Section III. 1.B. and Department rules and regulations.

ii. Disclosure required under Section III.1.A.i. shall include, but not be limited to, the following:

(a) For any income or loss in excess of \$500,000 reported on the taxpayer's [State] return as nonbusiness (business) income or loss, a list of all states for which such income or loss was treated as business (nonbusiness) income or loss.

(b) If the members included in the taxpayer's combined report or consolidated return filed in this state differ from the members included in the combined report or consolidated return filed in another state, the taxpayer shall identify each of the other states and provide for each such state a list of members: 1) included in this state that are excluded in that state, and 2) excluded in this state that are included in that state.

(c) For any total amount of property, payroll, or sales that in the aggregate exceeds 5% of the total that is included in the denominator of such apportionment factor for this state that is not included in the numerator of the apportionment factor of this state or any other state that apportions income using the same or similar apportionment factor, a list of the amount and rationale for the exclusion.

(d) Any other inconsistent filing position and information related to such position as the Director may require by regulation.

B. Time and Manner of Disclosure. Disclosures required by Section III.1. shall be filed within 6 months of the due date of an original [State] income tax return, and shall be filed with and attached to any amended [State] income tax return for any tax year, in the form and manner required by the Director, where such return reflects a reduction in tax resulting from an inconsistent filing position, including a reduction in tax due to a loss, deduction or credit which is being carried forward or back and which resulted from an inconsistent filing position taken in any year.

C. Effective Date. The provisions of this Section III.1. shall apply to any inconsistent filing position associated with any original or amended return filed on or after the effective date of this Act.

2. Retention and Provision of Records.

A. Retention and Provision of Records Required. A taxpayer shall retain a copy of its filings of [State] schedule [apportionment schedule identifier] and of the equivalent schedule filed by the taxpayer in such other state or states for which the taxpayer's [State] filing reflects an inconsistent position and shall, within 30 days of written request, provide a copy of such schedules to the Director. Information required to be retained under this Section III.2. for any tax year shall be retained for that period of time during which the taxpayers' income tax liability to this state for that tax year may be subject to adjustment, including all periods in which additional income taxes or penalties may be assessed, or during which a protest, appeal or lawsuit is pending with respect to [State] income tax, but not less than ten years from the due date or extended due date of the return.

B. Effective Date. The provisions of this Section III.2. shall apply to information associated with any return due on or after the date two years prior to the enactment of this Act. Provided however, during the course of an audit investigation, the Director may, following the effective date of this Act, require provision of such information as may be in possession of the taxpayer (or, if applicable, a member of the taxpayer's combined reporting group) for any tax year for which the statute of limitations on assessment has not expired.

3. Penalties Related to Failure to Disclose, Provide or Maintain Information Regarding an Inconsistent Filing Position.

A. Imposition and Amount.

i. A taxpayer that fails to fully disclose, retain or provide any information with respect to an inconsistent filing position as required by Section III.1 and 2. of this Act and Department rules and regulation, shall be subject to penalty in an amount determined under Section III.3.A.ii., in addition to any other applicable penalties.

ii. (a) For failure to file a disclosure of inconsistent filing positions as required pursuant to Section III.1., the amount of the penalty shall be the greater of \$10,000 or 0.25 percent of the amount of net income properly apportioned and allocated to this State.

(b) For failure to provide information required to be retained under Section III.1. C. within 30 days of a request by the Director, there shall be assessed a penalty in the amount of \$[X]. An additional penalty in the amount of \$[Y] shall be assessed with respect to each additional 30 days thereafter during which the information is not provided. A taxpayer that has not retained the information required under Section III. 1. C., shall, after submitting an affidavit that such information does not exist, be subject to a penalty in the amount of \$[Z] in lieu of additional 30 day penalties.

B. Assessment Date. Penalty imposed under Section III.3.A.ii.(a) shall be due on the due date of the schedule upon which disclosure of the inconsistent filing

position was required pursuant to Section III.1 and Department rules and regulations. The penalty imposed under Section III.3.A.ii.(b) shall be due on the 30th day following a request by the director, and, if applicable, every 30 days thereafter for which taxpayer fails to provide the information required to be retained pursuant to Section III.2 .

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 III.3. with respect to any violation if rescinding the penalty would promote compliance with the requirements of this Act and effective tax administration.

ii. Notwithstanding any other law or rule of law, any determination by the Director under this subdivision may not be reviewed in any administrative or judicial proceeding.

D. Effective Date. Penalty imposed under this Section III.3. shall apply to any failure to disclose, retain or provide any information regarding an inconsistent filing position, as required pursuant to Section III.1. or 2., with respect to any tax year ending on or after the effective date of this Act.

4. Extension of Statute of Limitations for Assessments Associated with Non-Disclosure of an Inconsistent Filing Position.

If a taxpayer fails to fully disclose all information required under Section III.1 of this Act and Department rules and regulations with respect to an inconsistent filing position, The time for assessment of any tax imposed by [State Income Tax Act] with respect to such filing position shall not expire before the date which is one year after the date on which the Director is furnished the information so required. Extension of the statute of limitations under this Section III.4. is limited to extension for purpose of assessment of a tax deficiency, penalty and interest resulting from an application of the proper tax treatment with respect to the inconsistent filing position that was not disclosed.

5. Presumption and Burden of Proof.

A taxpayer shall be presumed to be liable for any underpayment of tax properly assessed by the Director, where such underpayment resulted from a filing position, which is an inconsistent filing position, as defined in Section I.3, with respect to a position taken in another state with substantially similar law. The taxpayer may overcome such presumption by submission of clear and convincing evidence to the contrary.