



# U.S. International Tax Compliance Substance Over Form-Reportable Transactions

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# Reportable Transactions Background

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- Final Tax Shelter Regulations Issued 2/28/03
- Regulations Greatly Expanded Scope of Form 8866 Reporting
- Regulations Do Require Tax Professionals to Maintain Lists With Respect to Reportable Transactions Where Fees Exceed Specified Amounts



# Tax Reporting Requirements

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## Tax Shelter Disclosure Regulations-Form 8866

- Listed Transactions
- Confidential Transactions
- Transactions With Contractual Protection
- Loss Transactions
- Transactions With Significant Book/Tax Differences
- Transactions With Brief Asset Holding Periods



# Tax Reporting Requirements

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## Listed Transactions

- Described in IRS Notices On Point
- “Substantially Similar” Transactions Included
- De Facto No Section 6662 Substantial Authority Exists

## Confidential Transactions

- Disclosure Required Where Tax Advisor Is Paid A “Value Added” Fee and Imposes a Limitation on Disclosure Designed to Protect the Confidentiality of The Tax Advisor’s Tax Strategies



# Tax Reporting Requirements

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## Contractual Protection

- Transactions Where Taxpayer Has a Right to Full or Partial Refund of Fees Or Tax Advisor's Fee Is Contingent On Realization of Tax Benefits

## Loss Transactions (Corporations/Partnerships)

- Single Year \$10 Million; Multiple Years \$20 Million
- Irregardless of Use of Loss (E.G. NOL's)
- Applies to CFC Losses, U.S. Shareholder to Report
- Exceptions
  - Asset Sales (Cash Paid Basis); Casualty/Involuntary Conversions; Losses From Section 1221(b) Designated Hedging Property



# Tax Reporting Requirements

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## Book/Tax Differences

- \$10 Million In a Single Taxable Year-Gross, No Netting
- U.S. GAAP for Book Income Determination
- SEC Companies With Gross Assets Over \$250 Million
- Rev. Proc. 2003-35 Exceptions (30) Include:
  - Turning of Book Loss Previously Reported W/O Tax Deduction
  - Turning of Tax Income Previously Reported W/O Book Deduction
  - Depreciation; Depletion; Amortization; Bad Debts; Taxes
  - Independent Contractor Comp; Charitable Contributions;
  - Tax Exempt Interest; DRD's; Like Kind Exchanges; Debt/Debt
  - Reorgs; Section 481 Adj.; Sale for Tax Purposes; FX; FAS 133;
  - Inventory; Environmental Remediation; Hedge Accounting
- Rev Proc 2004-45 M-3 Satisfies Book to Tax Reporting



# Tax Reporting Requirements

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## Short Asset Holding Periods

- Applies to Transactions Generating Tax Credits Over \$250K For Assets Held Less Than 45 Days

## CFC Reporting

- Disclosure of Reportable Transactions By CFC
- Current and Preceding Five Years
- No U.S. Tax Impact Required
- Exception For Book/Tax Differences if No Subpart F Reduction or Elimination



# Form 8866 Specific Issues

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- Listed Transaction Notices
  - [www.irs.gov/businesses/corporations](http://www.irs.gov/businesses/corporations)
    - Click on Abusive Tax Shelters
- What is a Transaction?
  - All factual elements relevant to expected tax treatment of any investment, entity, plan, arrangement including series of steps to carry out transaction
- What is Substantially Similar?
  - Same or similar tax benefits
  - Same or similar facts
  - Same or similar strategy





# Relevant FASB Developments

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## Fin 46 Variable Interest Entities

- An Entity Whose Equity Investment At Risk Is Not Sufficient To Finance Activities
  - Dependent On Financial Support From Investors
  - Investors Have Limited If Any Control On Entity Performance
  - Entity's Performance Is Measured By Variations In Income and Loss and/or Asset Values
- Subject to ARB 51 Consolidation for The Investor Whose Interest Absorbs The Majority of Entity's Risk/Reward
- Balance Sheet Consolidation Could Create Significant Temporary Differences Related To The Underlying Transaction.



# Financial Listed Transactions- Recent Developments

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- Notice 2004-67 Provides Latest Published Update of Listed Transactions
- Notice 2004-31 In re: Use of Intervening Partnership to circumvent Section 163(j) earnings stripping limitations:
  - FP and DC2 form PRS via contributions down.
  - PRS contributes property to DC 1 in exchange for preferred stock
  - DC 1 pays substantial dividends on preferred stock
  - PRS allocates DC1 dividends & its deductions to FP for payment for use of capital contributed by FP
  - PRS allocates to FP payment for use of capital contributed by FP
  - DC2 claims Sec 243 dividend deduction due to affiliation with DC 1 and deduction for guaranteed payments to FP allocated to it by PRS
- IRS Challenge to Transaction
  - Partnership form over substance per ASA Investering
  - Section 704(b) economic effect issue



# Financial Listed Transactions-Current Developments Cont'd

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- Notice 2004-19 Abusive FTC Transactions
  - Withdraws Rev. Proc 98-5 regarding issuance of regulations applying economic profit test to tax motivated FTC generating transactions
  - Restates Intent to challenge such transactions on following bases
    - Substance over form
    - Step transaction doctrine
    - Debt Equity Principles
    - Section 269 Principles
    - Partnership Anti Abuse Rules of Reg. 1.701-2
    - Substantial Economic Effect Partnership Rules of Reg. 1.704-1



# Financial Listed Transactions-Current Developments Cont'd

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- Notice 2004-20 Issued With Notice 2004-19
- Challenges FTC Generation In Following Circumstance
  - U.S. Parent acquires stock in Foreign Target Company
  - U.S. Parent makes Section 338 Election for Foreign Target
  - Foreign Target sells assets pursuant to prearranged plan
    - Generates foreign source income and related FTC
    - Excess FTC generated without U.S. E&P or income pickup due to tax basis step up effect of Section 338 election.