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Effective Responses to Aggressive Tax Planning

What Canada Can Learn from Other Jurisdictions

Instalment 9: The United States – Settlement Offers

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With a collaboration from
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This instalment is the ninth in a series that presents a detailed study on aggressive tax planning. It underpins the issuance of *Tax Paper No. 112* published in July 2009 by the Canadian Tax Foundation (CTF). As mentioned in the preface of the book in order to keep publishing costs reasonable and to avoid delaying its publication, the CTF has given us permission to publish this document in French and English on our website.

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UNIVERSITÉ DE SHERBROOKE

The Mission of the Research Chair in Taxation and Public Finance

The **Research Chair in Taxation and Public Finance** (RCTPF) was formed on April 15, 2003 via an unconditional grant from the Québec Government, to whom we are grateful. We are specifically thankfull to the Government for having given us total freedom in selecting topics we thought were important, thus expressing its confidence in the selection of our projects. In Québec, there are few official forums where practitioners, public-sector executives and researchers can discuss new issues in taxation and public finances. In addition, research in these fields generally focuses on a single discipline to the detriment of the multi-disciplinary aspect of relations between the state and its taxpayers. The **Research Chair in Taxation and Public Finance** was formed in response to these two realities. Its primary mission is to stimulate interdisciplinary research and training by bringing together professors and researchers interested in the political economy of taxation. For more information on the **Research Chair in Taxation and Public Finance**, visit its official Website at: http://www.usherbrooke.ca/adm/recherche/chairefiscalite/.

Gilles Larin holds the RCTPF. Marie Jacques is a full professor at the Université de Sherbrooke. Lyne Latulippe was a consultant at the RCTPF. Robert Duong[1] was a research professional with the RCTPF when this study was produced.

We wish to express our gratitude for their observations and suggestions to four readers who wished to remain anonymous. Of course, the opinions expressed herein are those of the authors, who assume full responsibility for the comments and interpretations in this study.

[1] Robert Duong, who is a lawyer, was a research associate with the Research Chair of Taxation and Public Finance at the University of Sherbrooke when this study was done. He is now working with the federal Department of Finance as a policy officer in the area of income tax. The views expressed in this publication are those of the authors and do not in any way represent the position of the Department of Finance of Canada. The material contained in this publication is not intended to be advice on any particular matter. No subscriber or other reader should act on the basis of any matter contained in this publication without considering appropriate professional advice. The publisher, and the authors and editors, expressly disclaim all and any liability to any person, whether a purchaser of this publication or not, in respect of anything and of the consequences of anything done or omitted to be done by any such person in reliance upon the contents of this publication.

Abstract

Instalment 9: United States – Settlement Offers

In 2005, the Research Chair in Taxation and Public Finance initiated studies on aggressive tax planning in light of concerns expressed by tax administrations, the courts, taxpayers and tax advisers (the **"stakeholders"**). This project analyses the tools developed by some of Canada's major trading partners in response to aggressive tax planning schemes put into effect by taxpayers and tax advisers.

This project aims to spark thinking among the various stakeholders in Canada by taking a comprehensive and pragmatic approach to the issues inherent in aggressive tax planning. In view of the scope of the subject, its complexity and the specific features of the tax systems of foreign countries, our study should be seen as a reflection on aggressive tax planning rather than an exhaustive analysis of each of the tools examined and all the associated issues. This project was written over a more than a two year period. As the underlying logic was the key element we wished to convey, we wish to emphasise that these documents do not necessarily represent the state of tax legislation or jurisprudence.

As part of this project, the Chair held a symposium in 2006 on the risks inherent in aggressive tax planning for all stakeholders and published a discussion paper detailing the major issues of these schemes.

This project is being pursued here by a study of the tools developed by Australia, United States, United Kingdom and European Union. Our goal is to assess whether it would be worthwhile for Canada to adopt one or more of these tools to safeguard its tax system. The assessment was carried out taking into consideration the point of view of each stakeholder, according to generally recognized principles of tax administration.

The study consists of 10 instalments detailing the study framework that guided our analysis of the tools developed in other countries and our study of each of the selected tools. The 10th instalment which was to be the conclusions for Canada, is not published here, because it was recast and augmented to become Tax Paper No. 112, published in July 2009 by the Canadian Tax Foundation: *Effective Responses to Aggressive Tax Planning – What Canada Can Learn from Other Jurisdictions*.

We refer the reader to instalment 1, "Study Framework", for an overview of our thinking throughout the instalments.

This specific instalment focuses on settlement offers proposed to taxpayers in respect of aggressive tax planning schemes in the United States. To our knowledge, such a tool has not been implemented in Canada in recent years. This instalment pinpoints the key application details of this tool and the questions inherent in its application for all stakeholders in the United States. In light of these observations, we have pinpointed in a preliminary manner possible solutions for Canada. The conclusions that we formulate concerning the application of settlement offers will be considered in the formulation of its general conclusions and recommendations in the wake of an examination of the entire array of foreign tools.

In our opinion, settlement offers represent a flexible tool for taxpayers and the tax administration to mitigate their respective risks regarding aggressive tax planning schemes. In the US context, taxpayers must deal with the risks that the tax advantages derived from such schemes be withdrawn because of the economic substance doctrine, that a penalty for under-stating tax payable be applied and that interest must be paid. Uncertainty remains, however, about the criteria of that doctrine and its application to each planning scheme. Therefore, it may be in the best interests of taxpayers and the tax administration alike to reach an out-of-court settlement rather than engaging themselves in a long, costly and unpredictable judicial litigation. The terms of settlement offers must be flexible and fair to ensure the long-term effectiveness of this tool.

A tax administration can issue settlement offers only if has tools that enable it to track down aggressive tax planning schemes and their participants. In that regard, the efficiency of US tax auditors coupled with disclosure rules for aggressive tax avoidance increase the possibilities of the US tax administration to identify the most aggressive schemes and taxpayers. In the US

context, the disclosure rules seems to play an important role given that some settlement offers were extended to taxpayers engaging into transactions that had to be reported under those rules.

Therefore, we think that the efficiency of settlement offers depends on whether aggressive taxpayers face a genuine risk that the US tax administration identifies them, and depends as well on the probabilities that the courts would uphold an assessment based on the economic substance doctrine and on the possibility of the application of the penalty for under-stating tax payable. Nonetheless, the tax administration must have the time and resources that would allow the completion of the audit and the closing of the files of participating taxpayers.

Table of Contents

1

General Context

We refer the reader to Instalment 5, entitled “The United States - General Context and Presentation of the American Broad-Spectrum Approach.”

Instalment 5 presents an overview of the tools applied by the US tax administration, using in particular case law to illustrate the application of these tools.

2

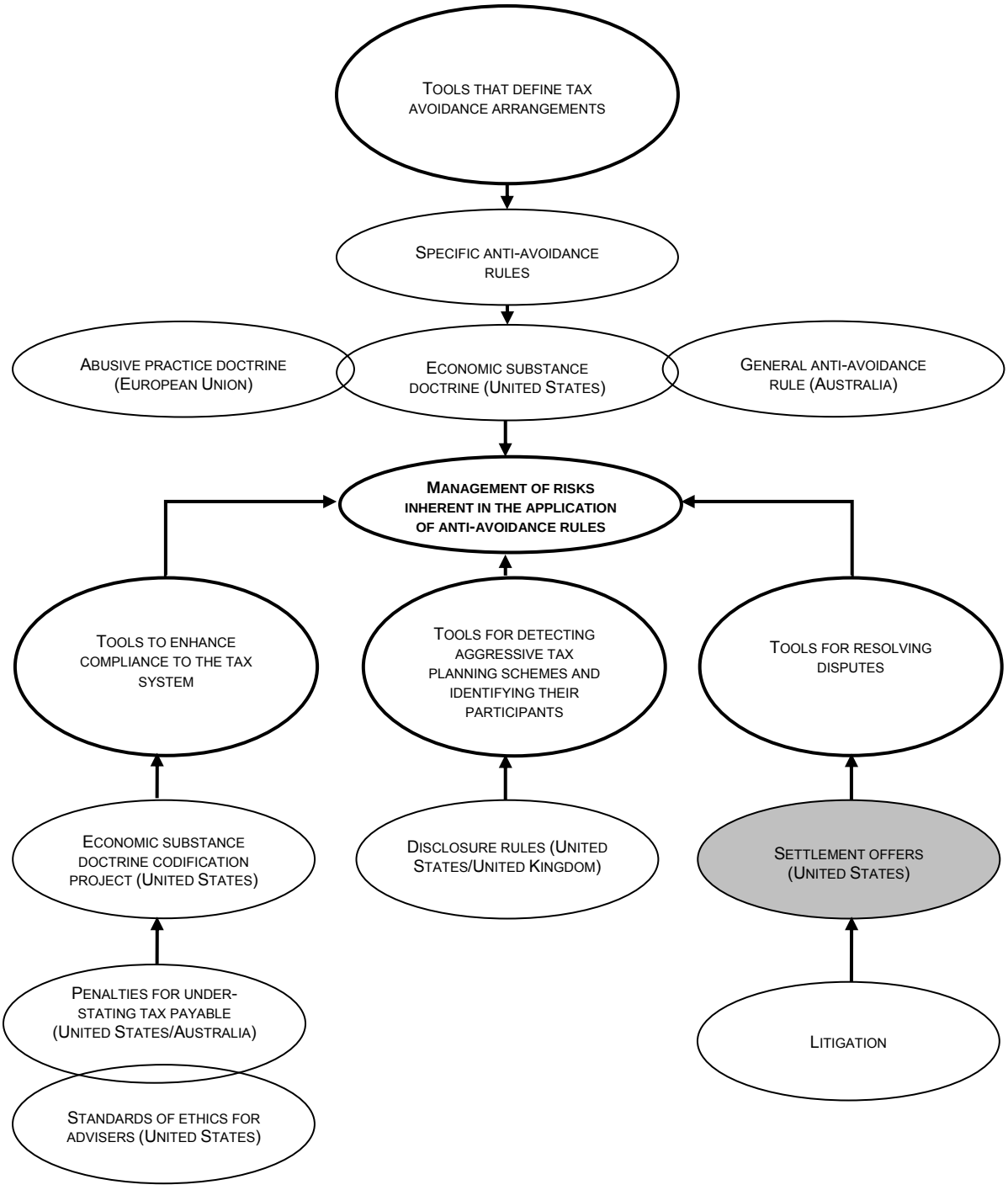
Context of Settlement Offers

As discussed in Instalment 1, "Study Framework", of this study, there are a number of tools available to a tax administration to better curb abusive tax avoidance arrangements and increase the risk for aggressive taxpayers and advisers. These tools can be divided into the following spheres of intervention of the tax administration:

- tools that define tax avoidance arrangements;
- tools to enhance compliance to the tax system;
- tools designed to detect aggressive tax planning schemes and identify their participants;
- tools that focus on resolving disputes.

Chart 1.1 on the following page provides a concise illustration of the relation between these spheres of intervention in managing the risks inherent in aggressive tax planning. Each sphere of intervention is shown in the chart using a bold border. The foreign tools selected for the purposes of the study are inserted in the appropriate spheres of intervention. The tool considered in this instalment, i.e. settlement offers, is indicated by a grey background to situate its role in the tax administration's management of the risks inherent in aggressive tax planning.

CHART 1.1
SPHERES OF INTERVENTION OF THE TAX ADMINISTRATION REGARDING AGGRESSIVE TAX PLANNING:
SELECTED TOOLS USED BY SOME OF OUR TRADING PARTNERS -
THE ROLE OF SETTLEMENT OFFERS IN THE UNITED STATES



Our Chart.

Stakeholders may express diametrically opposed opinions on the level of compliance of an aggressive tax planning scheme in respect of the tax law. Such disagreements stem from the uncertainty about the purposes of the tax rules read as whole and legal doctrines, including the economic substance doctrine.

In Instalment 6 of this project, we examined the uncertainty surrounding the application of the economic substance doctrine in the United States and the management by taxpayers of the risks that the tax administration and the courts will apply that doctrine to cancel the tax benefits claimed, as well as a penalty for under-stating tax payable. To better grasp the nature of the settlement offers and the management of this tool by taxpayers, advisers and the tax administration, we refer the reader to Instalment 6 for a detailed discussion of the economic substance doctrine.

Taxpayers who challenge a notice of assessment issued by the tax administration must establish that their planning schemes comply with the tax law. However, objection procedures may last several years and prove costly in terms of money and time, both for the tax administration and taxpayers, especially if the disputes revolve around complex questions involving substantial amounts of tax. These disputes may be further prolonged if the courts are asked to settle them.[2]

Faced with this situation, the US tax administration has, since 1990, emphasized alternative mechanisms to resolve a greated number of disputes with taxpayers. Since 2001, the tax administration has used its powers to make settlement offers to better manage the risks related to aggressive tax planning schemes of taxpayers and their advisers. The tax administration may reach written agreements with any taxpayer to settle any question pertaining to the taxpayers'

[2] See US, Internal Revenue Service, Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, *IRS Initiatives to Resolve Disputes over Tax Liabilities* (GAO/GGD-97-71), Washington, DC, United States Government Printing Office, May 1997 [IRS, *Initiatives to Resolve Disputes*], online GAO Website: < http://www.gao.gov/archive/1997/gg97071.pdf>.

obligations in respect of income tax.[3] It may launch offers both as regards taxpayers identified beforehand and any taxpayer who finds himself in a targeted situation.

[3] See 26 U.S.C. § 7121: "(a) Authorization. The Secretary is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period. (b) Finality. If such agreement is approved by the Secretary (within such time as may be stated in such agreement, or later agreed to) such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact- (1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States, and (2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded."

3

Description of Settlement Offers

To ensure the sound and efficient management of the tax system, the tax administration has offered taxpayers on various occasions the possibility of voluntarily disclosing, for a specified period of time, their participation in aggressive tax planning schemes in exchange for a reduction in or the cancellation of the penalties for under-stating tax payable that might apply.

The US tax administration has offered taxpayers the possibility to take up one of these offers since 2000. Tables A-01 to A-11 in Appendix 1 briefly describes each of these offers.[4] They display similar details, subject to the specific features attributable to the nature of the targeted planning scheme. These offers are listed below in chronological order:

- Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties;[5]
- Corporate Life Owned Insurance (COLI); [6]
- Section 302/318 Basis Shifting Transactions;[7]
- Section 351 Contingent Liability Transactions;[8]
- Settlement Offer for Son-of-Boss Tax Shelter;[9]
- Settlement Offer for Executive Stock Options Scheme;[10]
- SC2;[11]
- Personal Investment Corp. (PICO);[12]
- Partnership Options Portfolio Securities (POPS);[13]

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4 The reader will find the relevant references in each table. We will examine one or several of these offers throughout this instalment. In the interests of simplicity, we refer the reader to these tables to locate the relevant references. These tables were prepared primarily using information published by the American tax administration when these offers were proposed to taxpayers. We will update this information.

5 Table A-01 in Appendix 1.

6 Table A-02 in Appendix 1.

7 Table A-03 in Appendix 1.

8 Table A-04 in Appendix 1.

9 Table A-05 in Appendix 1.

10 Table A-06 in Appendix 1.

11 Table A-07 in Appendix 1.

12 Table A-08 in Appendix 1.

13 Table A-09 in Appendix 1.

- Abusive Transaction Settlement Initiative;[14]
- LILO/SILO Settlement Initiative.[15]

Briefly, the US tax administration has adopted different approaches to propose the offers:

- On the one hand, it has publicly issued settlement offers to all taxpayers;
- On the other hand, it has also issued private offers to taxpayers that it had already individually identified.
- Moreover, the public or private offers were either aimed solely at taxpayers who had carried out a planning scheme that the tax administration had targeted, or at all taxpayers regardless of the nature of the planning scheme.

The following table breaks down the above-mentioned settlement offers according to the approaches that the tax administration has adopted.

TABLE 3.1
BREAKDOWN OF THE SETTLEMENT OFFERS ACCORDING TO THE APPROACHES ADVOCATED BY THE TAX ADMINISTRATION

	OFFER TARGETED IN RESPECT OF IDENTIFIED PLANNING SCHEMES	GENERAL OFFER IN RESPECT OF PLANNING SCHEMES NOT IDENTIFIED BEFOREHAND
PRIVATE OFFERS (IDENTIFIED TAXPAYERS)	▪ *SC2* ▪ PICO ▪ POPS ▪ LILO/SILO Settlement Initiative	
PUBLIC OFFER (IDENTIFIED TAXPAYERS AND TAXPAYERS NOT IDENTIFIED BEFOREHAND)	▪ COLI ▪ § 302/318 Contingent Liability ▪ *§351 Basis Shifting* ▪ Son-of-BOSS ▪ Executive Stock Option	▪ Disclosure initiative for Certain Transaction Resulting in Waiver of Certain Penalties ▪ Abusive Transaction Settlement Initiative

[14] Table A-10 in Appendix 1.

[15] Table A-11 in Appendix 1.

3.1 Eligibility criteria

Eligible taxpayers must satisfy the following criteria on the day on which they subscribe to the settlement offer. Specifically, they:

- must have already carried out a planning scheme covered by the settlement offer;
- must not be involved in a planning scheme subject to a dispute with the tax administration concerning tax benefits stemming from the planning scheme in any taxation year;
- not be involved in a fraudulent planning scheme or have been subject or liable to a penalty for fraud;
- must file all of the documents pertaining to the targeted planning scheme, including the tax opinions issued by their advisers, or attest to their intention to provide the documents upon request;
- must be within the reassessment period in respect of any taxation year during which they claimed tax benefits stemming from the planning scheme.

3.2 The taxpayer must pay all or part of the amount of tax under-stated, plus the interest

Taxpayers must pay all or part of the amount of tax under-stated and the interest accrued on such amounts. The tax administration may allow taxpayers to claim a deduction in the calculation of their income of an amount corresponding to all or part of the expenses incurred to carry out the planning scheme as a business loss or a capital loss.

3.3 The tax administration reduces the applicable penalty rate

The tax administration agrees to not apply to taxpayers penalties for under-stating tax payable or to only levy a fraction ranging from one-quarter to one-half of the general penalty rate of the penalty for under-stating tax payable which, briefly, corresponds to 20% of the amount of tax under-stated.[16]

[16] It is possible for taxpayers to avoid a penalty for under-stating tax payable if they have disclosed the transactions in accordance with the disclosure rules or if they have relied on an impartial, reasonable opinion from their advisers. Instalment 6 (Economic Substance Doctrine) and Instalment 8 (Disclosure Rules) examine, respectively, the main criteria of the penalty for under-stating tax payable and the application of a penalty in relation to the disclosure rules.

3.4 Notice of participation by the taxpayer and payment

Taxpayers must notify in writing the tax administration of their intention to take up the offer before it expires by filing, as the case may be, the prescribed form containing the relevant information on the targeted transaction.[17] They must sign their notice of participation and solemnly attest that they satisfy all of the prescribed conditions in the offer. The tax administration will then propose to the taxpayers to finalize an agreement. The taxpayers must ratify this agreement and return it to the tax administration within 30 days of the date on which the tax administration sent the agreement. At the same time, they must pay the amount of the tax under-stated and the applicable interest and penalties.

3.5 Final agreement

The agreement reached by the tax administration and the taxpayer is final and settles any question concerning the implementation by the taxpayer of the transaction eligible for the settlement offer.[18]

3.6 Non-participating taxpayers

Once the offer expires, the tax administration will conduct audits and enforcement activities in respect of non-participating taxpayers, including recourse to the courts to settle disputes.

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[17] For instance, see IRS, Form 13750, Appendix 1, Table A-10, *infra* note 91; IRS, Form 13656, Appendix 1, Table A-06, *infra* note 83.

[18] See 26 U.S.C. § 7121(b).

4

Observations

Settlement offers have several benefits for the tax administration. Compared with litigation before the courts, the tax administration can rely on this mechanism to more quickly and predictably resolve disputes and at lower cost. It can also collect amount of income tax understated by taxpayers, as well as interest and penalties. Moreover, the tax administration may identify other taxpayers who have participated in planning schemes targeted by a settlement offer.

Settlement offers allow taxpayers to put their income tax position in order more rapidly and confidentially compared with a litigation before the courts the result of which is hard to predict. Settlements also afford them greater predictability about their income tax position as well as a reduction in the penalties that otherwise apply.[19] By subscribing to a settlement offer, taxpayers avoid paying the full amount of the tax, interest and penalties assessed by the tax administration in the event that the courts confirm the tax administration's notice of assessment. Moreover, they avoid incurring high legal fees to engage in litigation lasting several years.

Various indicators can be used to establish this tool's effectiveness. However, to our knowledge, the US tax administration has not published precise data or comprehensive analyses concerning settlement offers. The following indicators at least provide an overview of this tool:

- the nature of the planning schemes covered by the settlement offers;
- the amounts that the tax administration collects pursuant to such offers;
- the economies of scale achieved by the tax administration and the taxpayers according to:
    - the reduction in auditing costs for the tax administration and taxpayers;

[19] US, Treasury Inspector General for Tax Administration, *The Settlement Initiative for Investors in a Variety of Bond and Option Sales Strategies Was Successful and Surfaced Possible Next Steps for Curtailing Abusive Tax Shelters* (2006-30-065) March 2006 [TIGTA, *Settlement Initiative*], online on the TIGTA Website: <http://www.treas.gov/tigta/auditreports/2006reports/200630065fr.pdf>.

  - the identification by the tax administration of other taxpayers and other aggressive tax planning schemes;
  - the possibility for the tax administration to issue a notice of reassessment within the limitation periods;

- the participation rate by taxpayers according to the details of the settlement offer, including:
  - the private or public nature of the offer;
  - the general or targeted scope of the offer;
  - the application of the economic substance doctrine to the transactions targeted and the payment of the penalties for under-stating tax payable and interest;
  - the tax administration's appearance of impartiality;

- the participation rate according to the uncertainty surrounding the application of the tax law and the economic substance doctrine.

The following subsections will examine each of these indicators in light of the data made public by the tax administration and the characteristics of the settlement offers, bearing in mind the benefits for and concerns of stakeholders.

4.1 The US tax administration has collected additional revenues through settlement offers

These offers have enabled the US tax administration to collect taxes, interest and penalties more rapidly than by means of the usual administrative and legal procedures. One difficulty that arises is to determine the amount that the tax administration has collected in respect of each of these offers. To our knowledge, it has not systematically published statistics on each of the offers, although it has occasionally made public partial data on individual offers.

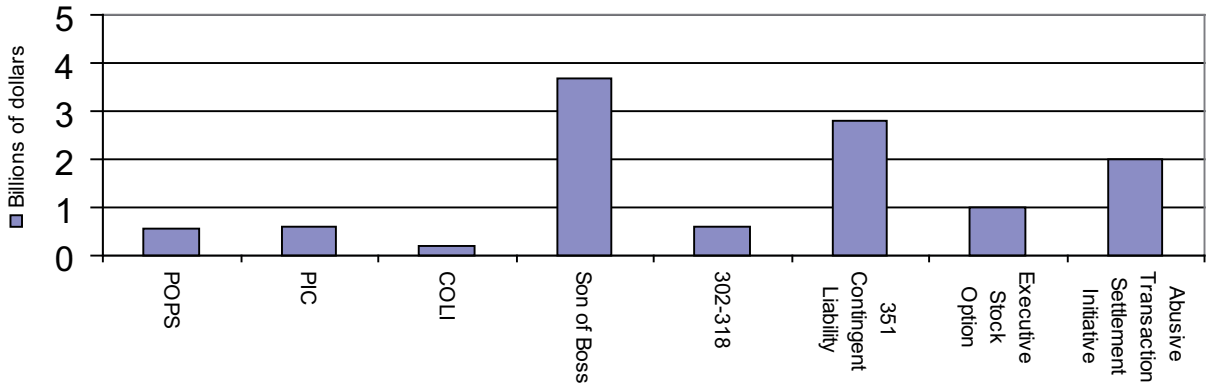
We have compiled the following information that were drawn from documents published by the tax administration, which gives a general idea of the amounts that it has collected pursuant to settlement offers. However, we are unable to ascertain whether the calculations were made according to a uniform methodology.

The tax administration collected at least US$5.8 billion in taxes, interest and penalties stemming from the Executive Stock Option Scheme, Son-of-Boss, Partnership Option Portfolio Securities and Personal Investment Corp Initiative offers. Moreover, it estimated at $3.6 billion the amount

of tax that it could recover under the Corporate-Owned Life Insurance, § 351 Contingent Liability and § 302/318 Basis Shifting offers.

Chart 5.1 breaks down the $9.4 billion collected or to be collected by the tax administration pursuant to the abovementioned offers. This amount corresponds to roughly 11% of the $85 billion in under-stated income tax attributable to aggressive tax planning schemes inventoried by the tax administration as of September 30, 2003, and to 3% of the tax gap for 2001.[20]

Chart 4.1
Estimation by the tax administration of the amounts collected or to be collected pursuant to settlement offers



Source: Chart elaborated by the authors based on information drawn from documents published by the American tax administration: we refer the reader to the tables in the appendix. To our knowledge, the tax administration has not systematically published statistics on each of the settlement offers. We are unable to ascertain whether the calculations were made according to a uniform methodology.

To determine the efficacy of settlement offers, the amounts of taxes, interest and penalties that the tax administration has collected should be compared with the amounts that it could collect from all taxpayers who have implemented a transaction that is eligible for the settlement offers. By way of illustration, the tax administration achieved a recovery rate of at least 62% in respect of the Son-of-Boss offer (it collected $3.7 billion in taxes, interest and penalties of an estimated US$6 billion in under-stated tax stemming from the implementation of the transaction).[21]

[20] Instalment 5 of this study provides more detailed data on the tax gap in general and in respect of aggressive tax planning schemes.

[21] TIGTA, *Settlement Initiative*, *supra* note 19.

However, as we will see in subsection 4.3, a disparity may arise between a preliminary estimate of the number of taxpayers who have carried out a transaction and, subsequently, an estimate of the total number of taxpayers who apparently implemented it. This disparity is attributable to the tax administration's inability to identify all of the taxpayers who have carried out a planning scheme eligible for a settlement offer before such an offer is made. Therefore, it is impossible to accurately determine an efficiency rate for each of the settlement offers solely according to the amounts collected by the tax administration pursuant to a settlement offer.

4.2 The US tax administration is able to achieve economies of scale through settlement offers

4.2.1 Reduction in auditing costs for the tax administration

The tax administration can make more efficient use of its professional staff by issuing settlement offers. In the case of the Son of a Boss initiative of July 2005, the tax administration incurred approximately $36 million in expenses but achieved savings of $54 million.[22]

4.2.2 Identification of otherwise unidentifiable planning schemes and aggressive taxpayers unknown to the tax administration

The tax administration can take advantage of information collected from taxpayers through settlement offers to detect other taxpayers and aggressive tax planning schemes of which it is unaware. In certain settlement offers, the tax administration prescribes as a criterion for participation that the eligible taxpayers disclose the identity of other taxpayers who had implemented a transaction eligible for a settlement offer or who might have participated in a such a transaction. In particular:

- the company executives who implemented the planning scheme targeted by the Executive Stock Option offer had to subscribe jointly to the offer with related persons who participated in it. The companies that participated in this planning scheme in favour of their executives had the possibility of taking advantage of the offer, but solely in respect of all of its executives who implemented it;[23]

[22] *Ibid.,* page 8.

[23] See Appendix 1, Table A-05: IRS, "Settlement Offer for Executive Stock Option Scheme" and IRS, "Executive Stock Option Initiative Terms," under section 3(d), *infra* note 82.

- the taxpayers who wished to subscribe to the Son-of-Boss offer had to provide the identity of the entities that participated in the planning scheme;[24]

- in the case of the Abusive Transaction Settlement Initiative, the tax administration reserved the privilege of denying taxpayers the possibility of taking advantage of the offer if the other parties to the transaction did not also subscribe to it;[25]

- the tax administration prescribed as criteria for participation in the Disclosure Initiative - Waiver of Penalties,[26] § 302/318 Basis Shifting[27] and Executive Stock Options[28] offers, that the eligible taxpayers disclose the identity of any promoter who approached them and had a financial interest in their implementing the transaction and, if the taxpayers were aware of it, the identity of anyone who advised the promoter.

4.2.3 The US tax administration is targeting, in particular, planning schemes that present the highest risks of avoidance, i.e. listed transactions pursuant to the disclosure rules

A number of planning schemes eligible for targeted settlement offers are transactions that the tax administration has declared to be listed transactions pursuant to the disclosure rules. By way of illustration, the Son-of-Boss offer stems from the identification of the planning scheme targeted therein through the disclosure rules.[29] For the purposes of the disclosure rules, the tax administration will declare a planning scheme to be an aggressive tax planning scheme when it is of the opinion that it can be likened to avoidance.[30] The tax administration then appears to focus its efforts on the planning schemes that it believes present the highest risks of avoidance.

The disclosure rules allow the tax administration broader leeway to quickly launch settlement offers to a greater number of taxpayers. The tax administration's simultaneous reliance on the

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24 See Appendix 1, Table A-10: IRS, "Abusive Transaction Settlement Initiative" and IRS, "Fact Sheet on Abusive Transaction Settlement," *infra* note 90.

25 *Ibid.*

26 See Appendix 1, Table A-01: IRS, "2002 Disclosure Initiative for Certain Transactions", *infra* note 69.

27 See Appendix 1, Table A-04: IRS, "Basis Shifting Transactions Settlement", *infra* note 74.

28 IRS, *Executive Stock Option Initiative Terms*, *supra* note 23; IRS, Form 13656, Appendix 1, Table A-06, *infra* note 82.

29 Eileen J. O'Connor (Assistant Attorney General Tax Division), testimony, "Statement of Eileen J. O'Connor, Assistant Attorney General, Tax Division, Before the Committee on Finance, United States Senate, Concerning 'Corporate and Partnership Enforcement Issues,'" June 13, 2006 [O'Connor, *Statement on Enforcement Issues*], online Website of the United States Senate Committee on Finance: <http://finance.senate.gov/hearings/testimony/2005test/061306testeo.pdf>.

30 26 C.F.R. § 1.6011-4(b)(2); 26 U.S.C. § 6707A(c). We refer the reader to Instalment 8, devoted to the American disclosure rules.

disclosure rules and settlement offers also makes it possible to overcome, to some extent, difficulties in identifying aggressive taxpayers and issuing them a notice of reassessment within the three-year reassessment period.

4.2.4 The US tax administration nonetheless has difficulty issuing a notice of reassessment within the three-year period even pursuant to settlement offers

These offers help the tax administration overcome difficulties in completing audits pertaining to avoidance within the three-year assessment period stipulated by the US *Internal Revenue Code.* The tax administration nonetheless finds itself unable to complete all of its audits within the prescribed time limits, since it does not have the necessary staff. In the case of the Son-of-Boss initiative, the tax administration estimated at $21.9 million the amount of tax that it was unable to collect from 71 income tax returns that were not audited within the prescribed time. The same problem arises in respect of transactions covered by the disclosure rules, despite the extension of the reassessment period.[31]

Table 4.1, which is reproduced in full from the report submitted by the tax administration concerning this settlement offer, describes in detail the analysis conducted as regards the number of days that auditors needed to analyse income tax returns and issue a notice of reassessment to taxpayers who have implemented the transaction covered by the offer.

[31] See TIGTA, *Settlement Initiative*, *supra* note 19; The Honorable J. Russell George (Treasury Inspector General for Tax Administration), testimony, "A Closer Look at the Size and Sources of the Tax Gap," Hearing before the U.S. Senate Committee on Finance Subcommittee on Taxation and IRS Oversight, July 26, 2006, online: website of the U.S. Senate Committee on Finance <http://finance.senate.gov/hearings/testimony/2005test/072606rg.pdf>.

TABLE 4.1
AVERAGE NUMBER OF DAYS THAT THE TAX ADMINISTRATION REQUIRES TO AUDIT AN INCOME TAX RETURN PERTAINING TO THE SON OF BOSS TRANSACTION

Figure 2: Time Periods for Examining Son of Boss Investor Returns and Assessing Additional Taxes Owed

Milestones for Participants and Nonparticipants in the Son of Boss Settlement Initiative	*Average Days*	*Median Days*
Participating Investors		
Identification Date to Examination Start Date	495	545
Examination Start Date to the Earlier of the Assessment Date or September 30, 2005	384	288
Overall Time Period for 1,380 Income Tax Returns Analyzed in This Category	869	966
Nonparticipating Investors		
Identification Date to Examination Start Date	470	508
Examination Start Date to the Earlier of the Assessment Date or September 30, 2005 (↗)	453	399
Overall Time Period for 578 Tax Returns Analyzed in This Category	894	1,006
Overall Time Periods for 1,958 Tax Returns Analyzed in Both Categories	877	972

(↗) We used September 30, 2005, as a cutoff date for 369 examinations that were ongoing as of this date.
Source: Compiled by the TIGTA from the Examination Records Control System and the Office of Tax Shelter Analysis databases.[6] For the taxpayer data used in the compilation, a promoter was contacted by the IRS for an audit of promoter activities.

Source: Table reproduced by the authors, drawn from TIGTA, *Settlement Initiative*, *supra* note 19.

Faced with the time required to audit an income tax return, the tax administration could always demand of the taxpayer that he agree to an extension of the reassessment deadline if the deadline ended in the 12 months following the date on which the taxpayer took advantage of the offer.[32] If he refuses, the tax administration might seek to take advantage of the extended six-year tax assessment period which, however, only applies in the event of a substantial omission of income.[33]

In this instance, the taxpayers must establish that their income tax return and the related documents provided sufficient information to enable the tax administration to identify the tax

[32] See the details of the Abusive Transaction Settlement Initiative offer presented in Appendix 1, in Table A-10, in particular the IRS document entitled "Terms of Abusive Transaction Settlement," *infra* note 90, under section 4(f).

[33] 26 U.S.C. § 6501(e)(1)(A). This substantial omission is equivalent to an amount equal to 25% of the taxpayer's gross revenue for the taxation year in question.

elements and ascertain their nature and amount in order to conduct additional audits within the three-year reassessment period.[34]

The tax administration will take advantage of this extended assessment period when the taxpayers have carried out an aggressive tax planning scheme under circumstances that can be likened to fraud and have failed to declare the amounts in their income tax return. To this end, it will analyse the information provided by the taxpayers in their income tax returns to ascertain whether it was possible for them to track the transaction or if it had been hidden, especially if the transaction proves to be complex.[35]

The courts, including the US Tax Court, seem to be of the opinion that the understatement or overstatement of an amount cannot be considered a substantial omission insofar as the amount is indicated in the taxpayer's income tax return.[36] In conjunction with aggressive tax planning schemes, taxpayers may declare an amount of income tax payable and file information on their tax attributes that are either overstated or understated in order to minimize their tax payable. The tax administration might apply the economic substance doctrine to adjust the taxpayers' tax attributes.

The tax administration is of the opinion that the overstatement or understatement by taxpayers of tax attributes in their income tax return can be likened to a substantial omission of income. In a case involving taxpayers who carried out the Son-of-Boss planning scheme,[37] the tax administration opined that the planning scheme carried out by these taxpayers was devoid of economic substance and that they should have declared a capital gain of roughly $3.2 million

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[34] For a brief explanation of the questions related to the extension of the reassessment period in the US context, see Sheryl Stratton, "With Six-Year Statute, IRS Pulls Out All Assessment Stops for Shelters," (May 1, 2006) 111 Tax Notes 536, 2006 TNT 84-5. See *Brandon Ridge Partners* v. *United States* (July 30, 2007), No. 8:06-cv-01340-T-24MAP (D. Tampa), [*Brandon Ridge Partners*], pages 14-15. In this case, the District Court had to determine whether the taxpayers had filed the information necessary to allow the tax administration to verify in a reasonable manner the accuracy of the capital gain declared by the taxpayers. By taking into account the taxpayers' individual income tax returns and those of the general partnerships of which they were members, the court concluded that the taxpayer made a substantial omission of income in the income tax return and that he had not filed the necessary information.

[35] See Appendix 1, Table A-05: IRS, "IRS Offers Son of Boss Settlement", and IRS, "Son of Boss Settlement Initiative", *infra* note 80.

[36] See *Grapevine Imports, Ltd* v. *United States* (July 17, 2007), No. 05-296T (Ct. Fed. Clms.); *Bakersfield Energy Partners, LP* v. *Commissioner of Internal Revenue Service* (June 14, 2007), 128 T.C. 17.

[37] *Brandon Ridge Partners*, *supra* note 34.

instead of a gain of $30,000. The tax administration issued a notice of reassessment to the taxpayers, but beyond the usual three-year reassessment period.

The District Court concluded in this case that the overstatement of the adjusted cost base of certain assets by the taxpayers in their income tax return could be likened to a substantial omission of income and that the taxpayers had not provided sufficient information in their income tax return to enable the tax administration to identify these amounts in a reasonable manner. The tax administration was then entitled to issue a notice of reassessment beyond the three-year limitation period.[38] According to this court, the courts must describe the reasonable nature of an information filing in an income tax return or other related filing pursuant to the following principles:

> Section 6501(e)(1)(A)(ii) provides that an amount is not omitted if the "amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item." In the instant case, the nature of the amount omitted (i.e., long-term capital gain) was disclosed. However, the parties disagree as to whether the amount was adequately disclosed.
>
> *The adequate disclosure test of § 6501(e) has been described differently by different courts. Some courts interpret the test as being whether the return provides a "clue" as to the omitted item. ... Other courts interpret adequate disclosure to be more than "simply a clue which would be sufficient to intrigue a Sherlock Holmes," but less than "a detailed revelation of each and every underlying fact." .... There are still other variations of the meaning of adequate disclosure*.
>
> *Cases from the former Fifth Circuit, which are binding on this Court, have described the test as being: If an item of income is not shown on the face of the return or an attached statement "in a manner sufficient to enable the [IRS] by reasonable inspection of the return to detect the errors," then the item is not adequately disclosed*. ... Furthermore, the former Fifth Circuit has explained that in such a situation, an extended limitations period is warranted in order for the IRS "not to be penalized by a taxpayer's failure to reveal the facts," because the IRS "cannot be required to act promptly on information that is not known to it." ... Thus, the adequate disclosure provision of § 6501 "has to be read in light of its purpose, namely, to give the taxpayer the shorter limitations period where the taxpayer omitted a particular income item from its calculations but disclosed it in substance." CC&F Western Operations Limited Partnership v. C.I.R., 273 F.3d 402, 408 (1st Cir. 2001); see also Estate of William Fry v. C.I.R., 88 T.C. 1020, 1023 (U.S. Tax Ct. 1987)(stating that in order for there to be adequate disclosure, "[t]he statement must be sufficiently detailed to alert the [IRS] as to the nature of the transaction so that the decision as to whether to select the return for audit may be a reasonably informed one"); CC&F Western Operations Limited Partnership v. C.I.R., 2000 WL 1276708, at *4 (U.S. Tax Ct. Sept. 8, 2000)(stating that the test is "whether the need for an adjustment is 'reasonably' apparent from the face of the [...] tax return").[39]
>
> [our extracts and italics]

[38] *Ibid.,* pages 8-14.

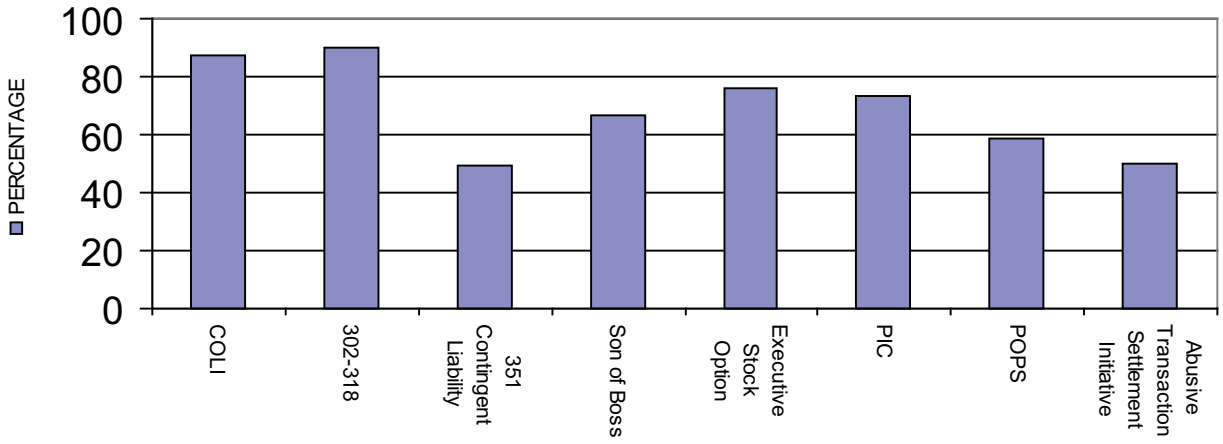
[39] *Ibid.,* pages 17-18.

4.3 Broader participation in offers made publicly to all taxpayers compared with targeted and private offers

4.3.1 Participation rate fluctuates between 50% and 85%, depending on the offers

The participation rate by taxpayers eligible for settlement offers provides a general idea of taxpayers' attitudes to such offers. As Chart 4.2 illustrates, the participation rate by taxpayers who are eligible for these settlement offers fluctuates between 50% and 85%.[40] These participation rates have been compiled based on documents published by the tax administration or information provided publicly by its officials in public speeches or meetings with professional organizations.

Chart 4.2
Participation rate by taxpayers eligible for certain settlement offers launched by the tax administration (IRS) between 2000 and 2006



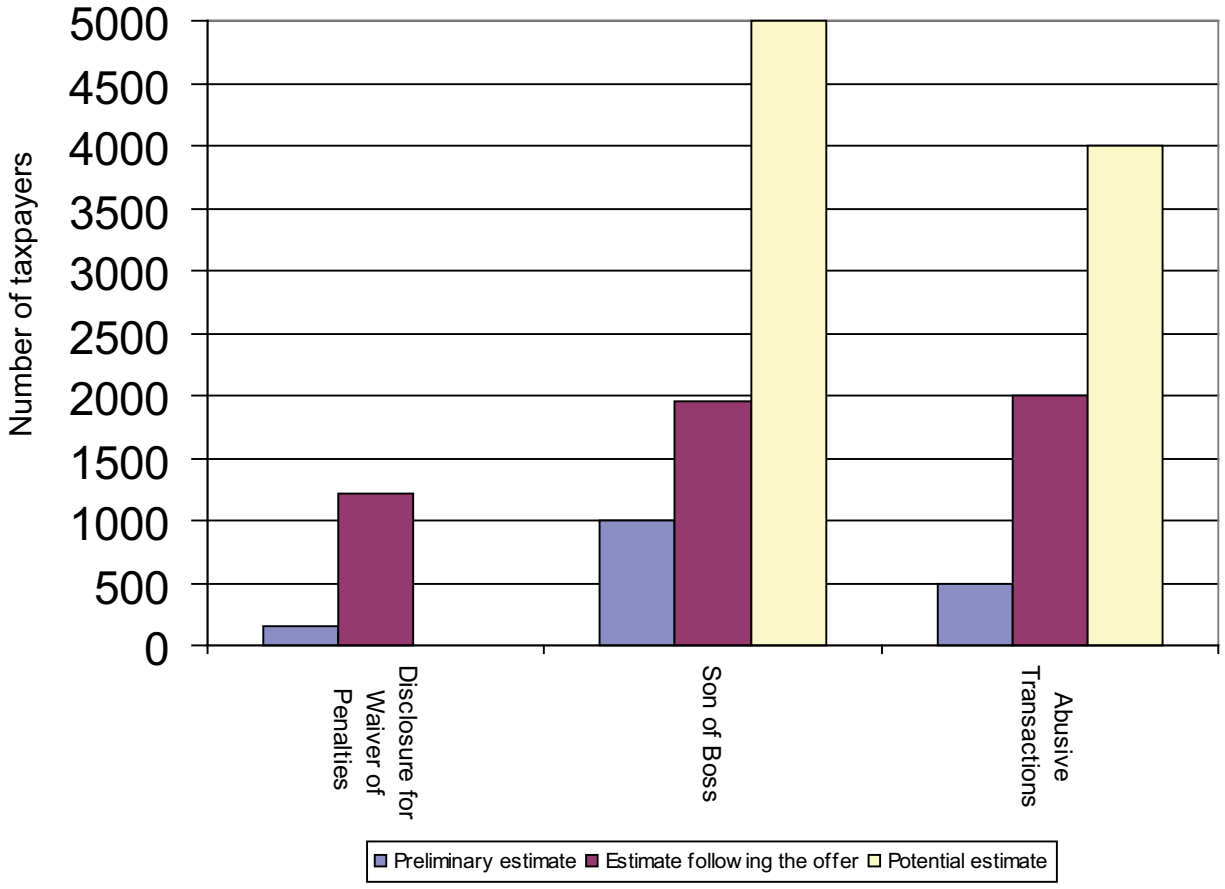
Source: Chart elaborated by the authors based on information drawn from documents published by the US tax administration: we refer the reader to Tables A-01 to A-11 in Appendix 1, which provide details concerning participation by taxpayers in each of the offers inventoried in the chart, and the relevant references. To our knowledge, the US tax administration has not systematically published statistics on each of the settlement offers. We are unable to ascertain whether it has collected relevant data according to a uniform methodology.

[40] The participants may include taxpayers who, in the opinion of the American tax administration, after verification, have not implemented a tax avoidance transaction. By way of illustration, the American tax administration concluded that 10 of the 124 executives indentified and four of the 46 companies pinpointed did not implement a tax avoidance transaction, i.e. just under 10% of the taxpayers and companies identified that participated in the Executive Stock Option offer. See IRS, "Response for ESO and Son of Boss," Appendix 1, Table A-06, *infra* note 84.

The tax administration has usually provided an estimate of the number of taxpayers who might be eligible for and subscribe to an offer at the time it was launched. These preliminary estimates do not necessarily tally with the number of taxpayers who have subscribed to a settlement offer, in particular offers that were launched publicly. This disparity clearly illustrates the impossibility for the tax administration of identifying all of the taxpayers who have implemented a transaction eligible for a settlement offer when the offer was launched, or of grasping the massive use of an aggressive tax planning scheme.

We have observed significant disparities in the estimated and actual number of participants in respect of the following offers: Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties, Son-of-Boss and Abusive Transactions Settlement Initiative. Chart 4.3 illustrates the disparities between the preliminary estimates of the number of taxpayers who would subscribe to an offer, the number of taxpayers who actually subscribed to the offer during the eligibility period and, if the tax administration had published this figure, the potential number of taxpayers who apparently implemented a transaction eligible for a settlement offer.

Chart 4.3
Estimates provided by the tax administration of the number of taxpayers who could subscribe to a settlement offer, the number who subscribed to it and the potential number of taxpayers who carried out the transaction covered by the offer



Source: Chart elaborated by the authors based on information drawn from documents published by the American tax administration: Tables A-01 in A-11 in Appendix 1 provides details on participation by taxpayers in each of the offers inventoried in the chart and the relevant references. To our knowledge, it has not systematically published statistics on each of the offers, nor has it published a potential estimate concerning the *Disclosure for Waivers of Penalties* offer. We are unable to ascertain whether the calculations were made according to a uniform methodology.

4.3.2 The tax administration has recorded a greater number of participants in a general offer than in most of the targeted offers

The number of participants in the general offer called "Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties", i.e. 1212 participants, is generally higher than the number of participants in each of the targeted offers for specific transactions. The tax administration had extended that offer to any taxpayer who had implemented any aggressive tax planning scheme, and then launched other offers covering specific transactions. The number of participants in the offer called "Abusive Transaction Settlement Initiative" offer reached nearly 2000 participants, which number is higher than the preceding offer, but covered 21 specific transactions. Exceptionally, more than 1200 taxpayers took advantage of the Son-of-Boss offer, i.e. the same number of participants as in the general offer.

A general settlement offer allows the tax administration to collect income tax without first having had to identify both the aggressive taxpayers and the types of planning schemes that they carried out. Such an offer enables it to collect information that it did not have both in respect of the taxpayers and the aggressive tax planning schemes. Whether the offer is general or targeted, the tax administration's success rate in a general offer nonetheless depends on other factors, as illustrated by the participation rate in the Son-of-Boss offer which focused on a single planning scheme.

4.3.3 The tax administration may reach settlements with more taxpayers pursuant to public offers than under private offers extended to a limited number of taxpayers

Before issuing private offers, the tax administration must first specifically identify the taxpayers who have carried out a given aggressive tax planning scheme through audit.

On the other hand, under a public offer, the tax administration may reach settlements with taxpayers that it has not identified when the offer was launched. The possibility of identifying more aggressive taxpayers increases if the offer is extended to all aggressive taxpayers rather than those who have engaged in a given planning scheme alone.

Without complete data, it is impossible to accurately put a figure to the total number of taxpayers that the tax administration did not initially identified and who took advantage of each

offer. Partial data nonetheless illustrate the possibility that unidentified taxpayers took up an offer launched publicly. In the following cases, some taxpayers took advantage of an offer although the tax administration did not identify them when it launched the offer:

- for the Executive Stock Option Initiative offer, four corporations and seven executives;[41]
- for the Son-of-Boss offer, over 300 taxpayers;[42]
- for the COLI offer, 10 taxpayers;[43]
- for the § 302/318 Basis Shifting offer, 234 taxpayers.[44]

4.4 The participation rate is influenced by the uncertainty surrounding the application of the tax law and the economic substance doctrine

Taxpayers may subscribe to or decline a settlement offer for various reasons. Their participation depends on their perception of the likelihood of their being subject to a tax audit but also the likelihood that the courts will confirm that tax administration's position concerning an eligible planning scheme, including the application of penalties for under-stating tax payable.[45]

The flexibility of the terms of a settlement offer may entice taxpayers to subscribe to it. In the case of the § 302/318 Basis Shifting offer, the taxpayers could claim part of the tax benefits and take advantage of the cancellation of penalties for under-stating tax payable, depending on their circumstances. However, the tax administration appears, increasingly, to be of the opinion that the courts would confirm the notices of reassessment that it would issue to taxpayers who are eligible for the offers. The offers launched since 2003 present less advantageous terms for taxpayers than those launched between 2000 and 2003:

- pursuant to the offer "Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties" launched in 2001, the taxpayers had to pay the full amount of the under-stated tax, without being subject to a penalty;

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41 See IRS, "Response for ESO and Son of Boss," Appendix 1, Table A-06, *infra* note 84.

42 IRS, *Response to Son of Boss*, Appendix 1, Table A-05, *infra* note 81.

43 Michael Brostek (General Accounting Office, Director, Tax Issues), Testimony before the Committee on Finance, U.S. Senate, "Internal Revenue Service: Challenges Remain in Combatting Abusive Tax Shelters," Hearing titled "Tax Shelters: Who's Buying, Who's Selling, and What's the Government Doing About It?" (GAO-04-104T), United States General Accounting Office, Washington, DC, October 21, 2003 [Brostek, *Abusive Tax Shelters*], pages 18-19, transcript available online: U.S. Senate Website: <http://finance.senate.gov/hearings/testimony/2003test/102103btest.pdf>.

44 *Ibid.*

45 O'Connor, *Statement on Enforcement Issues*, *supra* note 29.

- the § 351 Contingent Liability, § 302/318 Basis Shifting and COLI offers launched in 2002 required the taxpayers to agree to pay a fraction of the amount of tax under-stated, as determined by the tax administration, in addition to the interest and penalties;
- the offers launched since 2003 usually require the taxpayers to agree to pay the full amount of the tax under-stated determined by the tax administration, in addition to the interest and a fraction of the penalties.

The terms of the settlement offers set by the US tax administration depend, by and large, on the likelihood in the tax administration's eyes that the the courts would apply the economic substance doctrine to rescind the tax benefits under a planning scheme eligible for an offer as well as the penalty for under-stating tax payable.

4.4.1 In the long run, the application by the courts of the economic substance doctrine to planning schemes that are eligible for settlement offers may push taxpayers to subscribe to such offers

With regard to certain eligible planning schemes, the tax administration sought to withdraw the tax benefits pursuant both to the specific rules and the economic substance doctrine. For transactions similar to those covered by the offers Section 351 Contingent Liability, COLI and Son-of-Boss,[46] the courts have favoured the taxpayers' interpretation of the tax rules in question but have confirmed the tax administration's position concerning the application of the economic substance doctrine. As in for the COLI offer, the tax administration could grant taxpayers a grace period before putting an end to an offer of indeterminate duration when it wins its case before the courts in the meantime.[47]

It should be noted that the participation rate of taxpayers in the offers concerning the COLI and Son-of-Boss transactions stood at roughly 90% and 66%, respectively, while the participation

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[46] See Appendix 1, Tables A-05, A-06 and A-08. In July 2005, the tax administration estimated that over 100 cases pertaining to the Son-of-Boss planning scheme would be subject to litigation before the courts: see Appendix 1, Table A-06, *infra* note 84. In January 2007, the tax administration won a case concerning a transaction similar to the Son-of-Boss transaction: see *Klamath Strategic Investment Fund, LLC* v. *United States*, 472 F. Supp.2d 885 (E.D. Tex. 2007); (January 31, 2007), Civil Action No. 5:04-CV-278 (E.D. Tex.) [*Klamath*]. See also *RJT Investments X LLC* v. *United States* (June 6, 2006), 011769-05 (T. C.) [*RJT Investments*], upheld on appeal by the United States Court of Appeals for the Eighth Circuit on August 30, 2007, online: U.S. Tax Court Website: <http://psa.ustaxcourt.gov/UstcDockIng/asp/Index.asp>. In that case, the tax administration won on procedural issues but the ruling paved the way for the application of the economic substance doctrine to rescind tax benefits stemming from a transaction of this nature, without however reaching a final verdict on its application in that case.

[47] IRS, "IRS Offers Tax Shelter Settlements for Limited Times" and IRS, "Termination of COLI Initiative," Appendix 1, Table A-03, *infra* note 71.

rate in the Section 351 Contingent Liability offer reached only about 50%, the lowest participation rate among the offers that we have examined. After the launching of these offers, the courts concluded in respect of transactions identical or similar to those covered by the offers that the economic substance doctrine applied to rescind the tax benefits claimed by the taxpayers.

The low participation rate in the Section 351 Contingent Liability offer may be attributable to the belief among non-participating taxpayers that the asset that disposed of in the course of the targeted planning was evaluated in compliance with the law and the economic substance doctrine. Contrary to the COLI and Son-of-Boss offers, the tax administration offered the taxpayers eligible for the Section 351 Contingent Liability offer the possibility of deducting 75% of the capital loss that was claimed, or between 50% and 90% of this loss if the percentage was determined by a mediation process. In the tax administration's opinion, those terms adequately reflected the risks for the two parties to receive an unfavourable judgment[48] because of the uncertainty surrounding the application of the tax law and the economic substance doctrine to the facts and circumstances. The tax administration had introduced a mediation procedure to establish as fairly as possible the application of the tax law to the specific features of each of the transactions implemented.[49]

The tax administration has also observed a lower participation rate for certain transactions that were eligible for the Abusive Transaction Settlement Initiative offer that involved a possible dispute on the evaluation of assets bought or sold in those transactions. It opined that the taxpayers not participating in that offer believed that they were able to establish that their evaluation complied with the tax law and the economic substance doctrine.[50]

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48 Information drawn from Williams (IRS Chief Counsel), *Settlement or Litigation*, Appendix 1, Table A-02, *infra* note 72.

49 IRS, "Settlement Offer for Section 351 Contingent Liability Case," Appendix 1, Table A-04, *infra* note 77.

50 Stamper, "Global Settlement Netting 2,000 Taxpayers, $2 Billion," Appendix 1, Table A-10, *infra* note 92.

4.4.2 The possibility of fully or partly avoiding a penalty for under-stating tax payable increases the possibility that taxpayers will subscribe to a settlement offer

The main incentive for taxpayers to subscribe to a settlement offer is a reduction in the rate of the penalty for under-stating tax payable, which usually corresponds to 20% of the amount of tax under-stated. Taxpayers could avoid it depending on their degree of diligence and the circumstances surrounding each transaction. Moreover, taxpayers could avoid the penalty if, among other things, they had reasonable grounds to believe that the tax treatment claimed complied with the law according to the balance of probabilities. The rate of the penalty could reach 40% in the case of the under-statement of tax payable stemming from the significant under-statement of an asset, and 75% in the case of fraud.[51]

In settlement offers, the tax administration usually requires that taxpayers pay a fraction of the general penalty for under-stating tax payable. We have observed that the tax administration's policy governing the withdrawal or reduction of penalties for under-stating tax payable hinges on four main factors:

- The tax administration will not apply this penalty if the taxpayer has taken the necessary steps to ensure that the tax treatment claimed complies with the tax law and the economic substance doctrine according to the balance of probabilities, based on the advice of an impartial tax adviser.

- The tax administration will not apply this penalty if the taxpayer has disclosed his participation in the planning scheme that is eligible for the offer prior to the date of launching of the offer pursuant to the Disclosure Initiative-Waiver of Penalties offer.

- The tax administration will automatically apply a reduced penalty rate.

- The tax administration may apply a graduated penalty rate if the taxpayers have participated in other transactions that the tax administration has publicy decared that they are aggressive pursuant to the disclosure rules (listed transactions).[52]

Among the most recent offers, only the Abusive Transaction Settlement Initiative offer makes provision for the withdrawal of penalties if the taxpayer has relied on the impartial opinion of an

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[51] Instalment 6, "Proposed Economic Substance Doctrine Codification," and Instalment 8, "Disclosure Rules," set the context surrounding the penalties for under-stating tax payable and more fully describe their application.

[52] See the terms of the Son-of-Boss offer in IRS, "Terms of Son of Boss Settlement Offer," Appendix 1, Table A-05, *infra* note 80.

adviser focusing on the planning scheme's level of compliance with the law.[53] From the standpoint of the taxpayers, this possibility is an additional incentive to subscribe to a settlement offer. It seems fair given that the economic substance doctrine applies depending on the circumstances of each planning scheme. Given that several factors contribute to the participation rate by taxpayers in an offer, this incentive considered separately does not, however, ensure this tool's efficacy in light of the lukewarm response to the Abusive Transaction Settlement Initiative settlement offer, as Chart 5.2 shows.

The adjustment of the penalty rate applicable can encourage taxpayers to subscribe to an offer. The tax administration adopted this approach in the Son-of-Boss offer. Eligible taxpayers considered it advisable to subscribe to the offer faced with the risk of the tax administration's imposing on them the highest penalty rate, i.e. a penalty for fraud of 75% of the amount of tax under-stated.[54] If the taxpayers subscribed to the offer, they were only subject to a penalty rate of 10%, or 20% if they had carried out a listed transaction in addition to the planning scheme eligible for the offer. However, this approach depended on the identification beforehand by the tax administration of the taxpayers who had participated in this transaction. Based on the data available, we are unable to determine the number of participants who took advantage of this offer and who paid the 10% penalty rate.

In short, taxpayers must assess the likelihood that the courts will not apply the penalty for under-stating tax payable. If need be, they could opt for the objection procedure if the settlement offers only propose a simple reduction in the penalty.[55] However, according to the terms of the settlement offers, the taxpayers may not reasonably expect to receive from the tax administration a more favourable settlement offer through the objection procedure. They must then expect to appeal the notice of assessment before the courts and hope that the courts will conclude that their circumstances are distinctly different from those described in the settlement offers and will not apply the penalty for under-stating tax payable.

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53 See the terms of the Abusive Transactions Settlement Initiative offer, Appendix 1, Table A-10, *infra* note 90.

54 IRS, "Terms of Son of Boss Settlement Offer," Appendix 1, Table A-05, *infra* note 80.

55 Recently, in a ruling focusing on a planning scheme that displayed similarities to the Son-of-Boss case, the court applied the economic substance doctrine to withdraw the tax benefits claimed by the taxpayers but did not apply the penalty for under-stating tax payable on the grounds that the taxpayers could believe in good faith that the tax benefits were obtained in compliance with the tax law and the economic substance doctrine according to the balance of probabilities, in light of the opinion of their tax advisers. See *Klamath*, *supra* note 46.

4.4.3 The suspension in favour of the taxpayers of accrued interest on an amount of under-stated tax attributable to an aggressive tax planning scheme increases the possibility of the taxpayers' subscribing to an offer

Briefly, taxpayers must pay accrued interest on the amounts of tax under-stated as of the prescribed deadline for filing their income tax return. However, in the case of individuals, the calculation of the interest to be paid on an amount of tax under-stated may be suspended on the expiry of the 36-month period following this deadline if the tax administration has not issued a notice of assessment during this time limit. The interest then ceases to accrue on the day following the expiry of that period until the 21st day following the day when the tax administration issues to the taxpayer a notice of assessment. However, individuals who have under-stated their tax payable through the implementation of a transaction that the tax administration has publicly declared to be aggresive for the purposes of the disclosure rules (listed transactions) are not eligible for the suspension of interest. They must pay the interest on an amount of under-stated tax starting on the date of filing of the income tax return. [56]

To foster settlements with taxpayers, the US tax administration may offer both individuals and companies that are eligible for an offer the possibility of suspending the interest accrued on an amount of tax under-stated if they subscribe to the offer. This possibility was open in the Abusive Transaction Settlement Initiative offer. Since several factors contribute to the participation rate by taxpayers in a settlement offer, we do not, however, believe that this possibility considered separately ensures a high participation rate by taxpayers in a settlement offer, especially in light of the relatively low participation rate by taxpayers in that offer. Under that offer:

- The calculation of the interest payable by an individual who is eligible for the offer was suspended starting on the expiry of the 18-month time limit following the deadline prescribed for filing the income tax return, if the tax administration still had not issued to the taxpayer a notice of assessment.[57]

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[56] See 26 U.S.C. § 6404(g), as modified by *U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007*, Pub. L. No. 110-028, article 8242; 121 Stat. 112, page 200. This 36-month period applies to any notice of assessment that the tax administration issues after the expiry of the six-month period beginning on the day of coming into force of this law. When this measure was adopted in 2004, the suspension period began on the expiry of the 18-month time limit and ended 21 days after the date on which the American tax administration had issued to the individual a notice of assessment.

[57] See *Gulf Opportunity Zone Act of 2005*, Pub. L. No. 109-135, article 403; 119 Stat. 2577, page 2608.

- Individuals who decide to object to a notice of assessment through the usual procedure must pay the interest starting on the date of filing of the income tax return, since the tax administration did not appear at this stage to have the power to suspend the interest.[58]

4.4.4 Taxpayers who have carried out a standardized planning scheme in which the sole purpose is the obtaining of a tax benefit are more likely to subscribe to a settlement offer

In our opinion, taxpayers who carry out a standardized planning scheme engineered and implement by tax advisers who can be considered as promoters should pay particular attention to settlement offers. Usually, a standardized planning scheme can be used by any taxpayer regardless of his situation and is intended solely to generate a tax benefit. In such a case, the taxpayers could hardly allege that the planning scheme carried out differs from the one described by the tax administration in a settlement offer.

In both public and targeted offers, a considerable number of taxpayers not identified by the tax administration when the offers were launched took advantage of the Son-of-Boss and § 302/318 Basis Shifting offers, compared with the COLI and Executive Stock Option offers. That outcome could be explained by the fact that a greater number of taxpayers carried out planning schemes eligible for the § 302/318 Basis Shifting and Son of Boss offers because, in particular, of solicitations by the tax advisers.[59]

4.5 The risk of being identified by the tax administration through the disclosure rules may encourage aggressive taxpayers to subscribe to a settlement offer

The risk for taxpayers of being subject to an audit by the tax administration through the disclosure rules or other settlement offers and seeing the courts apply the economic substance doctrine may encourage them to subscribe to an offer. In the Son-of-Boss offer, such a risk may have encouraged taxpayers to subscribe to it given that the terms were not as flexible as for the § 302/318 Basis Shifting offer: the taxpayers had to relinquish all of their tax benefits and pay a fraction of the penalty for under-stating tax payable.

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[58] See David B. Robison, "Appeals' Role in Tax Shelter Settlement: Independence Affirmed" (2006) 58:2 Tax Executive 94 [Robison, "Independence of Appeals' Role in Settling Tax Shelter"].

[59] See Appendix 1, Table A-05: IRS, "IRS Offers Son of Boss Settlement" and IRS, "Son of Boss Settlement Initiative," *infra* note 80.

4.6 An appearance of partiality by the tax administration in managing settlement offers can undermine this tool's efficacy in the long run

To ensure the integrity of settlement offers, the tax administration must determine in a fair manner if the eligible transactions can be likened to abusive avoidance. The income tax return of a taxpayer who has implemented an aggressive tax planning scheme is subject to an analysis by the auditors, who issue to the taxpayer a notice of assessment. The taxpayer can subsequently file a notice of objection with the appeals division of the tax administration, which will confirm or modify the amount of tax determined by the auditors. Contrary to the auditors, the appeals division may propose settlement offers to the taxpayers according to the risk of the courts' ruling in the latters' favour.[60]

Tax advisers have expressed concerns over the bias of the appeals division in the context of settlement offers since this division participates in the elaboration of the terms of the settlement offers that the auditors must apply. They are of the opinion that the division's role in this process undermines the principle of independence between the auditors and the appeals division in the tax administration.

According to the tax administration, the settlement offers are formulated according to the characteristics generally found among all taxpayers who have implemented a given planning scheme and offer terms that are just as advantageous as those that the taxpayers might obtain through the objection procedure. The tax administration is of the opinion that taxpayers always have the possibility of concluding a settlement through an objection procedure under terms that are more favourable than those proposed by a settlement offer. However, the terms of some settlement offers gave the impression that the taxpayers could not in any way reach an agreement with the tax administration in terms that were fairer depending on their circumstances if they did not subscribe to a settlement offer for which they were eligible. The tax administration will ensure that it clarifies situations that undermine the appearance of impartiality in the appeals division.[61]

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60 See IRS, *Initiatives to Resolve Disputes*, *supra* note 2.

61 See US, Treasury Inspector General for Tax Administration, *The Overall Independence of the Office of Appeals Appears to be Sufficient* (2005-10-141) Washington, DC, September 2005 [TIGTA, *Office of Appeals*], pages 16-

Given the magnitude of the issues surrounding a given planning scheme, the tax administration could launch a settlement offer before the appeals division is able to analyse all aspects of the transaction covered by the offer. Tax advisers have voiced concerns with respect to a coercive settlement offer that would not allow non-participating taxpayers to resort to the objection procedure. Non-participating taxpayers would then have to appeal the notice of assessment before the courts. The tax administration advocated this approach in the Son-of-Boss offer[62] but stated that the appeals division must, from then on, complete its analysis of a planning scheme before launching a settlement offer.[63] The appeals division's involvement in settlement offers nonetheless raises other concerns regarding its lack of impartiality in relation to the auditors.[64]

Tax advisers have expressed their concerns over the unfair use of this tool by the tax administration to put pressure on taxpayers to subscribe to a settlement offer under terms that could be unfavourable to them.

Beyond the tax administration's appearance of partiality, taxpayers will subscribe to a settlement offer according to the possibility that the economic substance doctrine applies and that they must pay a penalty and interest, especially when the amounts in dispute are high for both parties. In the case of the Executive Stock Option Initiative offer, the tax administration estimated at US$400 million the amount of income tax under-stated by non-participating taxpayers.[65]

18, online on the TIGTA Website: <http://www.treas.gov/tigta/auditreports/2005reports/200510141fr.pdf>. See also Robison, "Independence of Appeals' Role in Settling Tax Shelter," *supra* note 58.

62 *Supra* note 35.

63 See TIGTA, *Office of Appeals*, *supra* note 61.

64 See Dustin Stamper, "Appeals Chief Addresses Appeals' Independence – Again" (October 1, 2007), 2007 TNT 190-9. See also American Bar Association (Section of Taxation), *Survey Report on Independence of IRS Appeals*, August 11, 2007, page 7, online on the ABA Website: <http://www.abanet.org/tax/irs/survey/appealssurvey07.pdf>. According to a survey conducted by the ABA among its members, approximately 73% of the respondents believe that the appeals division performs its duties fairly. Faced with this division's involvement in settlement offers, half of the respondents were unable to express an opinion on this topic, but 80% of the other respondents were of the opinion that this involvement undermined its impartiality.

65 See IRS, *Response for ESO and Son of Boss*, *supra* note 40.

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Conclusion

Given the general nature of the data that the US tax administration has published about settlement offers, we are unable to draw a final conclusion on its use of this tool. The additional information that the tax administration will provide in the wake of the report tabled in March 2006 concerning the Son-of-Boss settlement offer will give a broader picture of the management of the tax administration's and taxpayers' risks inherent to aggressive tax planning schemes through the application of this tool.[66] We can nonetheless make some preliminary observations concerning the details and application of this tool by the US tax administration. We believe that other tax administrations, including the Canadian tax administration, could rely on these observations to elaborate a fair approach in the realm of dispute settlement.

Through settlement offers, the US tax administration can recover what would otherwise be unrecoverable tax revenues because of the impossibility of identifying all taxpayers who have implemented an aggressive tax planning scheme and the limitations of the anti-avoidance rules, the economic substance doctrine and other administrative tools.[67]

The US tax administration is advocating a coherent approach in the realm of aggressive tax planning schemes. We have observed that it is focusing its efforts on the transactions that is has listed under the disclosure rules. It is, therefore, focusing its operations on transactions that display the highest risks of avoidance that are known to it and is relying on an array of tools to target them.

In combination with the disclosure rules, a general public offer allows the US tax administration to pinpoint taxpayers and aggressive tax planning schemes that are unknown to it. The efficacy of such an offer must then be evaluated overall and not solely according to the number of

66 The US tax administration announced a public consultation, from July 13, 2007 to September 11, 2007, to obtain comments on this settlement offer: see US, Department of Treasury, *Proposed Collection; Comment Request for Announcement 2004-46*, 72 F.R. 38656 (July 13, 2007).

67 A court ruled that the retroactive amendment to regulation that applied to a Son-of-Boss planning scheme could not apply to the taxpayer given that the latter impletemented the transaction before the time that the tax administration actually amended the regulation. See *Klamath Strategic Inv. Fund, LLC* v. *United States*, 2006 U.S. Dist. LEXIS 53949; No. 5:04-CV-278 (TJW) (E.D. Texas).

participants who subscribed to it or the amounts collected. Paradoxically, the US tax administration places greater emphasis, however, on launching private settlement offers, without specifying the reasons for adopting this approach.[68]

In light of these settlement offers launched by the US tax administration, we are of the opinion that this tool's efficacy depends on an array of factors and not a single factor viewed in isolation. The efficacy of settlement offers depends on the risk of detection, the amount of tax under-stated that the taxpayers will have to pay, the penalty rate for under-stating tax payable, and the amount of interest payable. A settlement offer that is effective for the US tax administration and fair to taxpayers might propose terms that reduce the amount that the taxpayers should pay overall for the amounts of tax under-stated, the penalties for under-stating tax payable, and interest.

We are of the opinion that taxpayers could be enticed to subscribe to a settlement offer if it seems possible that no penalty for under-stating tax payable will be imposed on them or that a small penalty will be levied if, among other things, the tax treatment can be deemed more likely to comply with the purposes of the law than to undermine such purposes. Such a possibility might enhance the fairness of the offers, especially when the taxpayers must file all of the documents relevant to the planning scheme that they have implemented or must have to disclose their participation in other aggressive tax planning schemes. The application by US courts of the economic substance doctrine in respect of certain listed transactions that were eligible for a settlement offer might heighten interest among all stakeholders in these offers.

We believe that the efficiency of settlement offers for the tax administration and taxpayers revolves, by and large, on the tax administration's fair treatment of taxpayers. These offers present taxpayers with the advantage of the tax administration's treating uniformly those who find themselves in a similar situation. The possibility to learn about the grounds on which the tax administration decides whether the participants have implemented a abusive tax avoidance transaction in each of the offers would further clarify the tax administration's use of this tool. An arbitration procedure would conform to the principle of fairness in the application of the tax law. To ensure this tool's integrity, the tax administration must offer fair, impartial treatment to the

[68] See Lisa M. Nadal, "IRS Official Discusses Enforcement Initiatives" (October 10, 2006), 2006 TNT 195-6.

taxpayers who, in their opinion, have implemented a transaction differently from that described in the settlement offer and who, for these reasons, wish to settle their dispute through the appeals process.

Appendix 1
Summary of the settlement offers

TABLE A-01
DISCLOSURE INITIATIVE FOR CERTAIN TRANSACTIONS RESULTING IN WAIVER OF CERTAIN PENALTIES[69]

PERIOD	▪ December 21, 2001 to April 23, 2002.
DESCRIPTION	▪ The offer was issued to all taxpayers who implemented a transaction that could be likened to tax avoidance and who were likely to be subject to a penalty for under-stating tax payable. ▪ All transactions were eligible except: - a transaction that the taxpayer did not actually implement; - fraudulent concealment by the taxpayer of an amount to be included in his income; - concealment by the taxpayer of his interest in a bank account in a foreign country; - concealment by the taxpayer of the disposition of an asset in favour of a foreign trust or the assignment of assets by this trust; - a deduction in the calculation of business income of an amount comparable to a personal expense.
TAX	▪ According to the analysis of the file.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ None, if the under-statement of the tax payable stemmed, in particular, from negligence, a significant under-statement of the tax payable or a significant under-statement of an asset or a service (except in respect of the transfer price).
PROCEDURE	▪ The taxpayer had to notify the tax administration of his intention to take advantage of the offer and file the prescribed information and documents, including the tax opinions and the identity of the promoters and, to his knowledge, the tax advisers who directly or indirectly helped him to implement the transaction.
NUMBER OF PARTICIPANTS	▪ 1212 taxpayers disclosed 1690 transactions.[70]
AMOUNTS COLLECTED BY THE IRS	▪ No data have been published, but the value of the deductions and losses claimed was estimated at $30 billion.
COURT RULING	▪ Unavailable

[69] US, Internal Revenue Service, Announcement 2002-2, "Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties Under § 6662 of the Internal Revenue Code" (December 21, 2001), 2002-2 I.R.B. 304 (January 14, 2002) [IRS, "2002 Disclosure Initiative for Certain Transactions"], online: IRS Website: <http://www.irs.gov/pub/irs-irbs/irb02-02.pdf>.

[70] According to the information published by the IRS on its Website (consulted on February 6, 2007).

TABLE A-02
CORPORATE LIFE OWNED INSURANCE (COLI)[71]

PERIOD	▪ The offer was launched in August 2001 and included a 45-day grace period starting on November 4, 2002 granted to taxpayers eligible for the offer.
DESCRIPTION	▪ The offer was extended to taxpayers who participated in what the tax administration declared to be a listed transaction pursuant to the disclosure rules. ▪ Briefly, this transaction sought to allow employers a deduction for interest paid on a loan to be used to invest in a corporate-owned life insurance taken on their employees, whereas the increase in value of the policy and death benefits were tax-free.
TAX	▪ Based on 80% of the value of the interest deducted.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ None, if the transaction was disclosed pursuant to the settlement offer.
NUMBER OF PARTICIPANTS	▪ As of February 25, 2003, 35 of the 40 eligible taxpayers who had not subscribed to the offer by November 4, 2002 subscribed to it before it expired.[72]
AMOUNTS COLLECTED BY THE IRS	▪ Unavailable ▪ The offer could potentially allow the tax administration to collect $200 million in tax according to the estimates provided in May 2003.[73]
COURT RULING	▪ Three rulings in favour of the tax administration: – *Winn-Dixie Stores, Inc.* v. *Commissioner*, 113 T.C. 254 (1999), upheld on appeal by 254 F.3d 1313 (11th Cir. 2001), cert. denied, 122 S.Ct. 1537 (2002). – *IRS* v. *CM Holdings, Inc.*, 254 B.R. 578 (D. Del. 2000), upheld on appeal by 301 F.3d 96 (3rd Cir. 2002), appeal filed on September 27, 2002. – *American Electric Power* v. *United States*, 136 F. Supp. 2d 762 (S.D. Ohio 2001), ruling appealed on April 20, 2001, No.01-3495 (6th Cir. 2001). ▪ In these three rulings, the courts applied the economic substance doctrine and denied the taxpayers the deduction of amounts paid as interest. In *CM Holdings*, the courts confirmed the application of a penalty for under-stating tax payable.

71 US, Internal Revenue Service, Announcement 2002-96, "Termination of Appeals Settlement Initiative for Corporate-Owned Life Insurance (COLI) Cases" (November 4, 2002) [IRS, "Termination of COLI Initiative"], online IRS Website: <http://www.irs.gov/pub/irs-utl/ann_2002-96_coli_-_10-04-02.pdf>; IR-2002-105, "IRS Offers Tax Shelter Settlements for Limited Times" (November 4, 2002) [IRS, "Limited Settlement Offer"], online IRS Website: <http://www.irs.gov/pub/irs-news/ir02-105.pdf>. See also Mark A. Luscombe, "How Significant is IRS COLI Loss in Dow Chemical" (2003) 81:6 *Taxes* 3.

72 See the information provided by B. John Williams, Jr., *Chief Counsel, Internal Revenue Service*, in a speech given on February 25, 2003 before the Chicago Bar Association (Federal Taxation Committee), entitled "Resolving Tax Shelters: By Settlement or Litigation" [Williams (IRS Chief Counsel), *Settlement or Litigation*]. Transcript available online IRS Website: <http://www.irs.gov/pub/irs-utl/shelters-feb25.pdf>.

73 Brostek, *Abusive Tax Shelters*, *supra* note 43, pages 18-19.

TABLE A-03
SECTION 302/318 BASIS SHIFTING TRANSACTIONS[74]

PERIOD	▪ October 4, 2002 to December 3, 2002.
DESCRIPTION	▪ The offer was extended to taxpayers who participated in what the tax administration declared to be a listed transaction pursuant to the disclosure rules. ▪ Briefly, this transaction sought to increase the adjusted cost base of shares held by a taxpayer who, after disposing of his shares, claimed a capital loss in the calculation of his income.
TAX	▪ The participants had to pay an amount of income tax calculated according to an adjusted cost base corresponding to 80% of the cost based calculated by the taxpayer. ▪ The participants could deduct as a capital loss 20% of the costs of the transaction as determined pursuant to the offer that they paid to implement the transaction.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ The tax administration would not levy a penalty if the taxpayer disclosed his participation in the transaction covered by this offer called "Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties" . ▪ Otherwise, the tax administration would impose a penalty for under-stating tax payable according to the circumstances of each taxpayer wishing to take advantage of the offer, bearing in mind that the taxpayer otherwise and voluntarily disclosed his participation in a transaction that was eligible for the offer.
PROCEDURE	▪ The taxpayer had to notify in writing the tax administration of his intention to subscribe to the settlement offer by December 3, 2002 at the latest.
NUMBER OF PARTICIPANTS	▪ As of October 21, 2003, over 90% of the eligible taxpayers had subscribed to the offer.[75]
AMOUNTS COLLECTED BY THE IRS	▪ Unavailable ▪ The § 302/318 Basis Shifting offer could potentially enable the tax administration to collect $600 million in tax according to the estimates provided in May 2003.[76]
COURT RULING	▪ Unavailable

[74] US, Internal Revenue Service, Announcement 2002-97, "Settlement Initiative for Section 302/318 Basis-Shifting Transactions" (October 4, 2002) [IRS, "Basis Shifting Transactions Settlement"], online IRS Website: <http://www.irs.gov/businesses/corporations/article/0,,id=107841,00.html>.

[75] Mark W. Everson, (Commissioner of Internal Revenue Service), testimony given at a hearing of the U.S. Senate under the theme "Tax Shelters: Who's Buying, Who's Selling, and What's the Government Doing About It?," Washington, DC, October 21, 2003 [Everson, *Tax Shelters*], transcript available online U.S. Senate Website (Committee on Finance): <http://finance.senate.gov/hearings/testimony/2003test/102103etest.pdf>.

[76] Brostek, *Abusive Tax Shelters*, *supra* note 43, pages 18-19.

TABLE A-04
§ 351 CONTINGENT LIABILITY TRANSACTIONS[77]

PERIOD	▪ October 4, 2002 to January 2, 2003.
DESCRIPTION	▪ The offer was extended to taxpayers who participated in what the tax administration declared to be a listed transaction pursuant to the disclosure rules. ▪ Briefly, this transaction sought to increase the value of a capital loss for a taxpayer at the time of disposition of shares of an affiliated company acquired in a rollover, in exchange for the assumption by the affiliated company of the management and payment of possible debts of uncertain value at the time of the transfer. At the time of this transfer, the taxpayer calculated the adjusted cost base of the shares without taking into consideration the assumption of the debt by the affiliated company. The taxpayer subsequently disposed of the shares of the company for a nominal value and claimed a capital loss the value of which corresponded to the present value of the contingent obligation. The affiliated company would subsequently deduct in the calculation of its income the amount that it paid to discharge the debt when it was realized.
TAX	▪ Based on a percentage of the loss claimed, ranging from 50% to 90% of the loss.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ None, if the taxpayer agreed to only deduct 75% of the loss claimed. ▪ Otherwise, a penalty might apply according to the circumstances of each participant, determined by a mediation procedure, but no penalty was applicable if the taxpayer disclosed the implementation of the transaction pursuant to the Disclosure Initiative - Waiver of Penalties settlement offer.
PROCEDURE	▪ The taxpayer had to submit to the tax administration a written request indicating his intention to subscribe to the settlement offer by January 2, 2003 at the latest. This request had to contain the prescribed information on the details of the transaction and the tax consequences of the taxpayers concerned.
NUMBER OF PARTICIPANTS	▪ As of October 21, 2003, 62 of the 126 eligible participants took up the offer.[78]
AMOUNTS COLLECTED BY THE IRS	▪ Unavailable ▪ The offer could potentially enable the tax administration to collect $2.8 billion in tax according to the estimates provided in May 2003.[79]
COURT RULING	▪ In favour of the tax administration. ▪ See *Coltec Indus., Inc.* v. *United States*, 454 F.3d 1340 (Fed. Cir. App. 2006).

[77] US, Internal Revenue Service, IR-2002-105, "IRS Offers Tax Shelter Settlements for Limited Times" (November 4, 2002); Rev. Proc. 2002-67, "Settlement of Section 351 Contingent Liability Tax Shelter Cases" (October 28, 2002) [IRS, "Settlement Offer for Section 351 Contingent Liability Case "], online IRS Website: <http://www.irs.gov/pub/irs-utl/revised_2002-67_rev_proc_10-28-02.pdf>.

[78] Everson, *Tax Shelters*, *supra* note 75.

[79] Brostek, *Abusive Tax Shelters*, *supra* note 43, pages 18-19.

TABLE A-05
SON-OF-BOSS TAX SHELTER[80]

PERIOD	▪ May 5, 2004 to June 21, 2004.
DESCRIPTION	▪ The offer was extended to taxpayers who participated in what the tax administration declared to be a listed transaction pursuant to the disclosure rules. ▪ Through the transaction, the taxpayers sought to artificially increase the adjusted cost base of their unit in a general partnership to claim a capital loss at the time of disposition of this unit to a third party for a nominal amount.
TAX	▪ 100% of the amount of the tax under-stated.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ None, if the taxpayer disclosed his participation in such a transaction pursuant to the offer called "Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties". ▪ Otherwise: - 10% of the amount of the tax under-stated if the taxpayer had not participated in any other listed transaction; - 20% of the amount of the tax under-stated if the taxpayer had participated in another listed transaction.
PROCEDURE	▪ The taxpayer had to submit to the tax administration Form 13582, Notice of Election to Participate in Announcement 2004-46 Settlement Initiative, by June 21, 2004 at the latest. ▪ The taxpayer then had to send the tax administration the settlement agreement prepared by the tax administration and pay the amounts of the tax, interest and penalties demanded pursuant to the agreement.
NUMBER OF PARTICIPANTS	▪ As of July 2005, over 1200 taxpayers among the 1975 taxpayers identified beforehand had taken advantage of this initiative.
AMOUNTS COLLECTED BY THE IRS	▪ As of July 2005, the amounts of the tax, interest and penalties collected by the IRS stood at $3.7 billion.[81]
COURT RULING	▪ Ruling handed down in favour of the tax administration: see *Jade Trading, LLC* v. *United States* (December 21, 2007), No. 03-2164T (U.S Ct. Fed Clms). ▪ Ruling handed down in favour of the tax administration concerning a similar transaction covered by this offer: see *Klamath Strategic Investment Fund, LLC* v. *United States*, 472 F. Supp.2d 885 (E.D. Tex. 2007).

[80] See US, Internal Revenue Service, IR-2004-64, "IRS Offers Settlement for Son of Boss Tax Shelter" (May 5, 2004) [IRS, "IRS Offers Son of Boss Settlement"]; IRS, FS-2004-13, "Son of Boss Settlement Initiative" (May 5, 2004) [IRS, "Son of Boss Settlement Initiative"]; IRS, Announcement 2004-46, "Son of Boss Settlement Initiative" (May 5, 2004) [IRS, "Terms of Son of Boss Settlement Offer"]. These documents are available online IRS Website: <http://www.irs.gov/newsroom/article/0,,id=123025,00.html>.

[81] US, Internal Revenue Service, IR-2005-72, "Robust Response for Executive Stock Option Initiative; Son of Boss Settlement Heading $4 Billion" (July 11, 2005); Internal Revenue Service, IR 2004-87, "Strong Responses to Son of Boss Settlement Initiative" (July 1, 2005) [IRS, *Response to Son of Boss*], online IRS Website: <http://www.irs.gov/newsroom/article/0,,id=124937,00.html>.

TABLE A-06
EXECUTIVE STOCK OPTIONS SCHEME[82]

PERIOD	▪ February 22, 2005 to May 23, 2005.
DESCRIPTION	▪ The offer was extended to company executives and companies that implemented what the tax administration declared to be a listed transaction pursuant to the disclosure rules. ▪ The transaction involved companies and their executives in which the latter transferred stock options to entities under family control, which, afterwards, exercised the options and disposed of the shares. In exchange, the entities under family control issued to the executives a note whose term only matured several years after the transfer of the stock options. Consequently, the executives deferred the taxation on the value of the advantages pertaining to the stock options.
TAX	▪ 100% of the amount of the tax under-stated.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ None, if the executive had disclosed his participation in the transaction prior to the launching by the tax administration of the offer pursuant to the offer called "Disclosure Initiative-Waiver of Penalties". ▪ Otherwise, 10% of the tax under-stated.
PROCEDURE	▪ The taxpayer had to submit to the tax administration Form 13656 for Executives and Related Persons by May 23, 2005 at the latest.[83] The companies had to file Form 13657 for Corporations. ▪ The taxpayer then had to return to the tax administration the settlement agreement prepared by the tax administration and pay the amounts of the tax, interest and penalties demanded pursuant to the agreement.
NUMBER OF PARTICIPANTS	▪ As of July 2005, the IRS had declared that 80 of the 124 executives identified and 33 of the 46 companies identified had taken advantage of the offer.
AMOUNTS COLLECTED BY THE IRS	▪ As of September 2005, the tax administration had collected $1 billion.[84]
COURT RULING	▪ Unavailable

[82] US, Internal Revenue Service, IR-2005-17, "Settlement Offer Extended for Executive Stock Option Scheme" (February 22, 2005) [IRS, "Settlement Offer for Executive Stock Option Scheme"], online on the IRS Website: <http://www.irs.gov/newsroom/article/0,,id=135596,00.html>; IRS, Announcement 2005-19, "Executive Stock Option Initiative" (February 22, 2005), 2005-11 I.R.B. 744 (March 14, 2005) [IRS, Executive Stock Option Initiative Terms], section 3(d), online IRS Website: <http://www.irs.gov/pub/irs-irbs/irb05-11.pdf>.

[83] US, Department of the Treasury (Internal Revenue Service), Form 13656, Notice of Election by Executive and Related Person to Participate in Announcement 2005-19 Settlement Initiative (March 2005) [IRS, Form 13656], online IRS Website: <http://www.irs.gov/pub/irs-pdf/f13656.pdf>.

[84] US, United States Government Accountability Office, Report to the Secretary of the Treasury, *Financial Audit IRS's Fiscal Years 2005 and 2004 Financial Statements* (GAO-06-137) November 2005, page 33; US, Internal Revenue Service, IR-2005-72, "Robust Response for Executive Stock Option Initiative; Son of Boss Settlement Heading $4 Billion" (July 11, 2005) [IRS, "Response for ESO and Son of Boss"], online IRS Website: <http://www.irs.gov/newsroom/article/0,,id=141014,00.html>.

TABLE A-07
SC2[85]

PERIOD	▪ The offer was launched privately on April 4, 2005 for a period of 30 days.
DESCRIPTION	▪ The transaction sought to create a deduction for charitable donation for the owner of shares of a pass-through entity as well as to defer and reduce tax on income of that flow-through entity by "allocating" income to a tax- exempt charity without distributing that income to the latter. ▪ The tax administration declared the transaction to be a listed transaction pursuant to the disclosure rules: Notice 2004-30, 2004-17 I.R.B. 828.
TAX	▪ 100%. ▪ 50% of the transaction costs granted as a deduction.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ 10% (instead of 20%). ▪ No penalty if the taxpayer had disclosed the transaction in conjunction with the settlement offer offer called “Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties”, launched in Announcement 2002-2.
NUMBER OF PARTICIPANTS	▪ 15 participants were offered this possibility.
AMOUNTS COLLECTED BY THE IRS	▪ Unavailable
COURT RULING	▪ Unavailable

[85] Sheryl Stratton and Crystal Tendon, “IRS Makes Settlement Offer to SC2 Investors” (April 7, 2005), 2005 TNT 66-1.

TABLE A-08
PERSONAL INVESTMENT CORP (PICO)[86]

PERIOD	▪ Unavailable
DESCRIPTION	▪ The tax administration deemed the transaction to be a listed transaction pursuant to the disclosure rules. ▪ The offer was extended to taxpayers who implemented a foreign exchange transaction under which an S Corporation attributed to them a loss on exchange without, however, attributing to them the gain on exchange.
TAX	▪ Unavailable
INTEREST	▪ Unavailable
PENALTY FOR UNDER-STATEMENT	▪ Unavailable
NUMBER OF PARTICIPANTS	▪ As of November 2006, 103 out of 141 shareholders had taken advantage of the offer.
AMOUNTS COLLECTED BY THE IRS	▪ The offer enabled the tax administration to collect US$592 million in taxes, interest and penalties according to the estimates provided in November 2006.[87]
COURT RULING	▪ Unavailable

[86] The US tax administration extended the offer privately to taxpayers that it had identified who had implemented the transaction: see Lee A. Sheppard, "News Analysis: Two-Minutes to Midnight: Settle Your Tax Case" (February 20, 2006), 2006 TNT 34-4 [Sheppard, "Settlement"].

[87] US, United States Government Accountability Office, Report to the Secretary of the Treasury, *Financial Audit IRS's Fiscal Years 2006 and 2005 Financial Statements* (GAO-07-136) November 2006 [GAO, *IRS 2006 and 2005 Fiscal Years*], pages 20-21.

TABLE A-09
PARTNERSHIP OPTION PORTFOLIO SECURITIES (POPS)[88]

PERIOD	▪ Unavailable
DESCRIPTION	▪ The tax administration declared the transaction to be a listed transaction pursuant to the disclosure rules. ▪ The offer was extended to taxpayers who, in the tax administration's opinion, carried out various transactions involving general partnerships to take advantage of the tax rules in order to claim a loss in the calculation of their income without having sustained an economic loss.
TAX	▪ 100% of the amount of the tax under-stated.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ 10% of the amount of the tax under-stated.
PROCEDURE	
NUMBER OF PARTICIPANTS	▪ As of November 2006, 63 out of 107 partners had taken advantage of the offer.
AMOUNTS COLLECTED BY THE IRS	▪ The offer enabled the tax administration to collect US$565 million in taxes, interest and penalties according to the estimates provided in November 2006.[89]
COURT RULING	▪ Unavailable

[88] The tax administration extended the offer privately to taxpayers that it had identified who had implemented the transaction targeted: Sheppard, "Settlement," *supra* note 86.

[89] GAO, *IRS 2006 and 2005 Fiscal Years*, *supra* note 87, pages 20-21.

TABLE A-10
ABUSIVE TRANSACTION SETTLEMENT INITIATIVE[90]

PERIOD	▪ October 27, 2005 to January 23, 2006
DESCRIPTION	▪ The offered covered 21 transactions. ▪ Among them, 16 were included in the 31 transactions that the tax administration declared to be listed transactions pursuant to the disclosure rules.
ELIGIBILITY	▪ The offer was extended to all taxpayers who had carried out these transactions.
TAX	▪ 100% of the amount of the tax under-stated.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ No penalty if: - the taxpayer had disclosed the transaction implemented in conjunction with the offer called "Disclosure Initiative for Certain Transactions Resulting in Waiver of Certain Penalties" ; or - in the tax administration's opinion, the taxpayer relied on an impartial professional opinion that concluded that the tax treatment claimed complied with the law according to the balance of probabilities. ▪ 5% for all the transactions except for a group of six transactions that were listed transactions. ▪ 10% to 20% for the group of six listed transactions.
PROCEDURE	▪ The taxpayer had to submit to the tax administration the prescribed form[91] and the prescribed documents by January 23, 2006 at the latest. ▪ The taxpayer then had to send to the tax administration the settlement agreement prepared by the tax administration and pay the amounts of the tax, interest and penalties demanded pursuant to the agreement.
NUMBER OF PARTICIPANTS	▪ As of April 2006, roughly 2000 of the 4000 eligible participants had taken advantage of the offer.[92]
AMOUNTS COLLECTED BY THE IRS	▪ As of April 2006, roughly $2 billion.[93]
COURT RULING	▪ Unavailable

[90] US, Internal Revenue Service, IR-2005-129, "IRS Launches Abusive Transaction Settlement Initiative" (October 27, 2005) [IRS, "Abusive Transaction Settlement Initiative"]; FS-2005-17, "IRS Settlement Initiative" (October 2005) [IRS, "Fact Sheet on Abusive Transaction Settlement"]; Announcement 2005-80, "Settlement Initiative" (October 2005) [IRS, "Terms of Abusive Transaction Settlement"]. These documents are available online IRS Website: <http://www.irs.gov/newsroom/article/0,,id=150072,00.html>.

[91] US, Department of the Treasury (Internal Revenue Service), Form 13750, Election to Participate in Announcement 2005-80 Settlement Initiative (October 2005) [IRS, Form 13750], online IRS Website: <http://www.irs.gov/pub/irs-pdf/f13750.pdf>.

[92] Dustin Stamper, "Global Settlement Offer May Net 2,000 Taxpayers, $2 Billion, Everson Says" (March 28, 2006), 2006 TNT 59-1 [Stamper, "Global Settlement Netting 2,000 Taxpayers, $2 Billion"].

[93] *Ibid.*

TABLE A-11
LILO/SILO SETTLEMENT INITIATIVE[94]

PERIOD	▪ August 7, 2008 to September 6, 2008 (this period was subsequently extended for 30 days).[95]
DESCRIPTION	▪ The offer targeted transactions commonly called sale-in, lease-out (SILO) and lease-in, lease-out (LILO). ▪ The UStax administration initially declared LILO transactions to be listed transactions for the purposes of the disclosure rules on February 28, 2000 (see also the subsequent declaration published on November 4, 2002).[96] ▪ The US tax administration had declared SILO transactions to be listed transactions for the purposes of the disclosure rules on February 11, 2005.[97]
ELIGIBILITY	▪ At least 45 companies, including financial and banking institutions.
TAX	▪ The taxpayers could only deduct 20% of the amounts of interest claimed, the amounts of rent paid, and the transaction costs claimed until 2007. ▪ The taxpayers had to include in the calculation of their income 80% of the original issue discount for the taxation years until 2007, even if the tax benefits were deferred in 2008. ▪ The IRS only considered 80% of any rental income declared by the participants for all taxation years until 2007. ▪ The participants had to dismantle their transactions. They could include in the calculation of their income on income account the gain realized at the time that they dismantled their transactions. However, the participants who do so after 2008 will be subject to specific rules.
INTEREST	▪ 100%.
PENALTY FOR UNDER-STATEMENT	▪ To be determined.
PROCEDURE	▪ The taxpayers had to provide within the stipulated deadline the information and documents demanded in the letter from the American tax administration, including those in Appendices 1 and 2 of the letter.[98]
NUMBER OF PARTICIPANTS	▪ Over one-third of the 45 participants that the US tax administration identified subscribed to the settlement offer.[99] ▪ Administrative audits and litigation concerning several hundred transactions had still not been completed when the offer was launched.
AMOUNTS COLLECTED BY THE IRS	▪ To be determined.
COURT RULING	▪ The government won the first three cases it litigated in court: see *BB&T Corp. v. United States,* No. 07-1177 (4th Cir. Apr. 29, 2008), *AWG Leasing Trust v. United States*, No. 1:07-cv-00857-JG (N.D. Ohio May 28, 2008),; *Fifth Third Bancorp v. United States,* No. 1:05-CV-350 (S.D. Ohio Apr. 17, 2008).

94 US, Internal Revenue Service, "IRS Commissioner's Remarks Regarding LILO/SILO Settlement Initiative" (August 6, 2008), online IRS Website: <http://www.irs.gov/businesses/article/0,,id=185874,00.html>. US, Internal Revenue Service, "LILO/SILO Initiative Frequently Asked Questions," online IRS Website: <http://www.irs.gov/businesses/article/0,,id=186294,00.html>. See also Jeremiah Coder, "IRS Launches Settlement Initiative for Corporate Tax Shelters" (August 7, 2008), 2008 TNT 153-1.

95 Jeremiah Coder, "IRS Extends Corporate Tax Shelter Settlement Offer by 30 Days" (August 25, 2008), 2008 TNT 165-1.

96 US, Internal Revenue Service, Rev. Rul. 2002-69, "Lease-In, Lease-Out or LILO Transactions" (November 4, 2002), online: IRS Website <http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html>.

97 US, Department of the Treasury, "Treasury Press Release on Abusive SILO Arrangements" (February 11, 2005), online on the IRS Website: <http://www.irs.gov/businesses/article/0,,id=152456,00.html>; Internal Revenue Service, Notice 2005-13, "Tax-Exempt Leasing Involving Defeasance" (February 11, 2005), online IRS Website: <http://www.irs.gov/businesses/article/0,,id=135286,00.html>.

98 US, Department of the Treasury (Internal Revenue Service), Letter 4395, *Resolutions of Lease-In/Lease-Out Transactions* (7-2008): see "IRS Releases Sample Letters for LILO, SILO Settlements" (August 6, 2008), 2008 TNT 153-15.

99 US, Internal Revenue Service, IR-2008-121, "IRS Sees Strong Response to LILO/SILO Settlement Offer" (October 21, 2008), online IRS Website: <http://www.irs.gov/newsroom/article/0,,id=187951,00.html>.

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