

# **Tax Shelter Reporting**

## **Introduction**

Chapters 61 and 63 of the Laws of 2005 added Section 25 to the Tax Law. Section 25, effective through July 1, 2007, requires every taxpayer required to file a reportable or listed transaction disclosure statement with the Internal Revenue Service to attach a duplicate disclosure statement to the New York tax return. Material advisors who are required by Internal Revenue Code Section 6112 to provide a statement with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction are required to provide a duplicate statement of such activities performed in New York to the New York State Tax Commissioner. This report fulfills the requirement of the Act to provide statistical information concerning these filings.

## **Summary**

The statistical information reported below is as of March 1, 2007. It is cumulative, reflecting all disclosures received since enactment of Section 25. To date, disclosures of nearly 30,000 reportable transactions have been received with nearly 10,000 returns. Included in these disclosures are 11,875 listed transactions. This count is split between two processing years. In 2005, disclosure form DTF-686 was filed with 4,856 personal income, partnership and fiduciary tax returns, and 711 corporate tax returns. Tabulations to date of 2006 returns show 4,151 personal income, partnership and fiduciary tax returns and 762 corporate tax returns filed with form DTF-686.

In addition, a total of 595 filings of form DTF-664 have been received from 120 different material advisors.

Section 25 will expire on July 1, 2007, absent legislative action to extend the provisions. With the disclosure during the last 20 months of approximately 12,000 tax shelter transactions participated in by New York taxpayers, it is clear that Section 25 of the Tax Law is working. It is the Department's view that requiring taxpayers to disclose those transactions that have the potential to be abusive tax shelters is essential to prevent erosion of New York's tax base. The information allows the Department to investigate the validity of certain transactions and target resources to prevent and remedy abusive situations. Continuing the disclosure requirement also has the benefit of continuing New York's close conformity to the Federal income tax bases.

The following tables and charts provide information concerning the distribution of disclosures of reportable and listed transactions received.

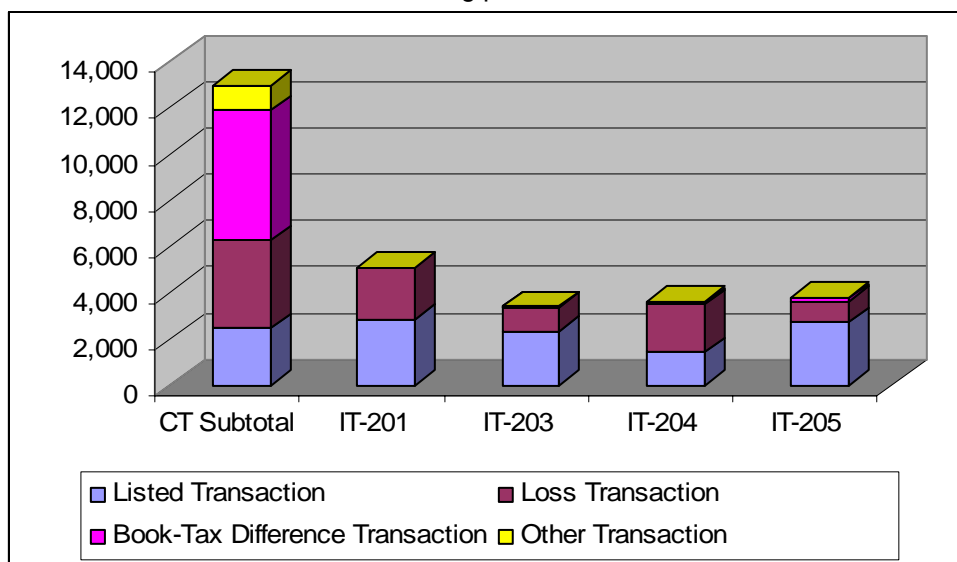
## Reportable Transactions

### Cumulative Reportable Transactions By Tax Return Type

Return Type	Listed Transaction	Loss Transaction	Book-Tax Difference * Transaction	Other ** Transaction	Total
CT-183	6	56	74	3	139
CT-184	7	45	296	12	360
CT-3	2,012	3,093	4,615	873	10,593
CT-3-S	54	162	30	0	246
CT-32	310	309	375	210	1,204
CT-33	104	123	180	1	408
<i>CT Subtotal</i>	<i>2,493</i>	<i>3,788</i>	<i>5,570</i>	<i>1,099</i>	<i>12,950</i>
IT-201	2,853	2,237	24	1	5,115
IT-203	2,341	1,026	46	8	3,421
IT-204	1,456	2,062	66	68	3,652
IT-205	2,732	913	138	7	3,790
<i>IT Subtotal</i>	<i>9,382</i>	<i>6,238</i>	<i>274</i>	<i>84</i>	<i>15,978</i>
<b>Grand Total</b>	<b>11,875</b>	<b>10,026</b>	<b>5,844</b>	<b>1,183</b>	<b>28,928</b>

\* A transaction where the amount for tax purposes differs by more than \$10 million on a gross basis from the amount of the item or items for book purposes. These transactions are no longer reportable transactions after January 5, 2006.

\*\* Includes confidential transactions, transactions with contractual protection, and transactions with brief assets holding period.



For the chart, all of the corporate tax CT forms are presented as a group, because the CT-3 disclosures received overwhelm the counts within the business taxes. The counts of transactions reported with IT-201 and IT-203 for resident and nonresident individual taxpayers, respectively, are presented separately, as are disclosures received with the IT-204, partnership, and IT-205, fiduciary income tax returns. While the chart shows counts

of transactions disclosed, it does not illustrate a significant point regarding corporate tax returns filed with a DTF-686. Although fewer than 2,000 corporate tax returns have been received to date, more than 12,000 reportable transactions were disclosed with these corporate tax returns. This shows a high average number of transactions disclosed per return. The first year of disclosure was for returns filed during the 2005 or 2006 processing year. Transactions entered into at any time that affected liability for the period covered by the return were required to be attached.

Unlike the abusive tax shelter transactions which taxpayers might have reported together with amended returns during the Department's Tax Shelter Voluntary Compliance Initiative (VCI) program to avoid penalty, most of the disclosed reportable transactions may prove to be within appropriate boundaries under the Federal and State tax laws. That is, they are protective filings by taxpayers disclosing transactions that the taxpayer has reason to believe will not materially change the taxpayer's liability for the period covered by the return.

### **Listed Transactions**

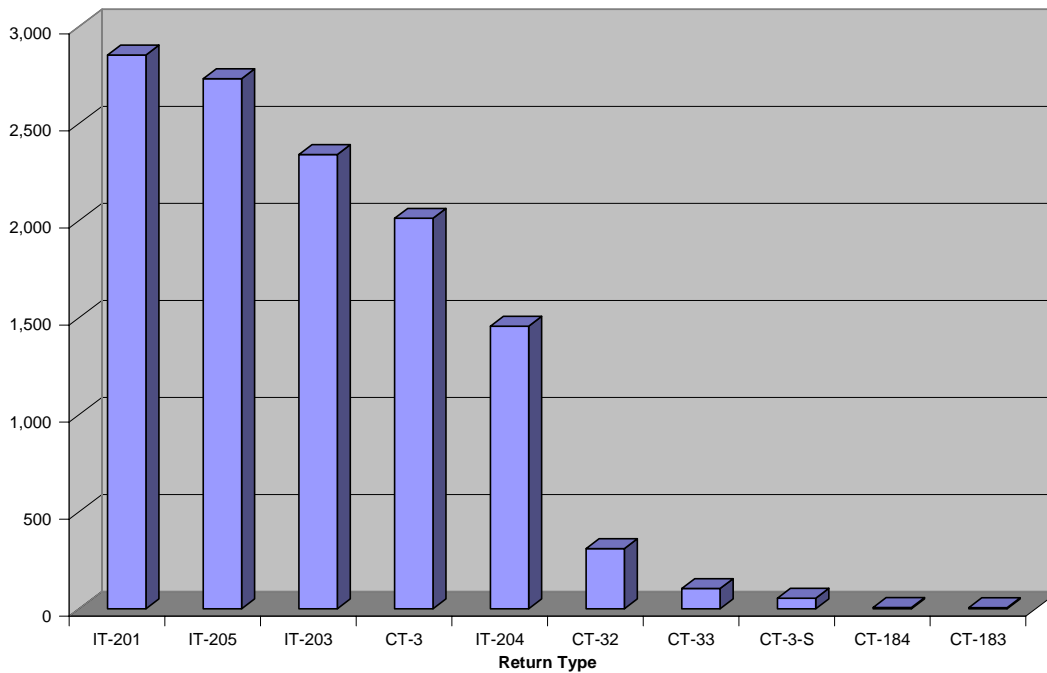
The following table presents cumulative counts of the types of listed transactions disclosed to date. Text of the Internal Revenue Service Rulings and Notices that define these types of transactions as tax shelters are provided in Appendix E of the *New York State Tax Shelter Voluntary Compliance Initiative* report. It should be noted that the nearly 9,000 filings pursuant to IRS Notice 2002-35 may fall under the more recent guidance provided by the IRS in IRS Notice 2006-16 to substantially narrow the scope of reportable transactions under IRS Notice 2002-35.

### **Cumulative Listed Transactions**

#### **Listed Transaction Detail**

Notice 2002-35	8,966	Notional Principal Contracts
Revenue Ruling 2000-46	1,517	401K Accelerators
Notice 2005-13	284	Sales-In Lease Out Transactions (SILO)
Notice 2003-77	265	Contested Liability Trusts
Revenue Ruling 2000-12	229	Debts Straddles
Notice 2001-17	89	351 Contingent Liability
Notice 2003-47	45	Transfers of Compensatory Stock options to Related Persons
Notice 2002-70 (Notice 2004-65)	33	De-list Producer Owned Reinsurance Companies (PORC)
Notice 2002-50	27	Partnership Straddle Tax Shelter
Revenue Ruling 2002-69	23	Lease In/Lease Out (LILO)
Notice 2003-54	22	Common Trust Fund Straddle Tax Shelter
Notice 2005-11	12	New penalty Section 6707A and Rescission Authority
Notice 2000-44	5	Son of Boss
Notice 2000-60	4	Stock Compensation Transactions
Notice 2001-16	4	Intermediary Transactions
Notice 2003-55	6	Accounting for Lease Strips and Others Stripping transactions
Notice 2006-16	4	Related to the Notice 2002-35 Notional Principal Contract
Revenue Ruling 99-14	4	LILO Transactions
Others	336	
	<u>11,875</u>	

**Counts of Listed Transactions**



### **Data Limitations and Considerations**

Although this report provides the most current depiction of the results of Section 25 of the Tax Law, there are several characteristics of the data that should be considered when evaluating the information.

First, it should be noted that most of the returns received during the New York State Tax Shelter Voluntary Compliance Initiative (VCI) are not included in these tabulations. Instead, details on the type of listed transactions reported and revenues received during the VCI are available in the **New York State Tax Shelter Voluntary Compliance Initiative**, available on the Department's Web site.

Second, pursuant to the authority of the legislation, regulations were adopted in December 2006 defining New York Reportable Transactions as including: New York Listed Transactions, New York Confidential Transactions, and New York Transactions with Contractual Protection. These categories, and their definitions, are modeled after their Federal counterparts. No disclosures of New York Reportable Transactions have been received, to date.

Taxpayers are required to file each year and to attach duplicates of those Federal disclosure forms that affect the current liability period. Therefore many of the disclosed transactions affecting current liability may also have been disclosed in the 2005 tax year. In addition, there are data entry lags due to filing timelines (i.e. calendar year or fiscal year filers, short period returns, etc.), filing extensions, and data processing and

verification routines, resulting in incomplete tabulation of the number and type of Federal reports of transactions attached to disclosure forms received in the 2006 tax year.

Finally, there is probably some duplication between the disclosures of reportable transactions by partnerships and fiduciaries with those filed by individuals. This is because the partnership or fiduciary files a disclosure statement at the entity level, while the respective partners or beneficiaries file a corresponding statement with their individual returns.

## **Conclusions**

Although the Department has less than two full years of experience with the disclosure requirement in effect, we believe the reporting requirement should be made permanent. It is clear that substantial numbers of Federal reportable and listed transactions have been entered into by New York taxpayers. It is essential to prevent erosion of New York's tax base to continue to require that taxpayers disclose those transactions that have the potential to be abusive tax shelters. Continuing the reporting requirements will have both direct and indirect effects. Directly, reporting transactions to the Department allows us to investigate the validity of certain transactions and target resources to prevent and remedy abusive situations. Indirectly, reporting requirements have a deterrent effect. They communicate to the taxpayer that the Department is monitoring these transactions and therefore discourage aggressive filing positions. This has the effect of shifting collections from the "back-end" audit process into up-front, voluntary compliance.

If we continue to follow IRS rulings and procedures, we will also maintain New York's strong history of close compliance to Federal net income bases.