



STATE OF CONNECTICUT
DEPARTMENT OF REVENUE SERVICES

AN 2004(5)

25 Sigourney Street
Hartford CT 06106-5032

ANNOUNCEMENT

Abusive Tax Shelter Compliance Initiative

Purpose: This Announcement alerts taxpayers, accountants, lawyers, and financial professionals of a Connecticut Department of Revenue Services (DRS) compliance initiative for participants in abusive tax shelters.

Effective Date: June 16, 2004.

Background: In 2002, the United States Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs initiated an investigation into the development, marketing, and implementation of abusive tax shelters by professional organizations such as accounting firms, banks, investment advisors, and law firms. During the investigation, the Subcommittee issued numerous subpoenas and document requests, and the Subcommittee staff reviewed hundreds of thousands of pages of documents and conducted numerous interviews with representatives of professional organizations. The evidence reviewed by the Subcommittee establishes that the development and sale of potentially abusive and illegal tax shelters has become a lucrative business for professional organizations. The evidence also shows that some professional firms are spending substantial resources to design, market, and implement hundreds of complex tax shelters, some of which are illegal and improperly deny federal and state governments billions of dollars in tax revenues.

In light of this evidence, the Internal Revenue Service (IRS) and many state revenue departments have launched an aggressive campaign to shut down the use of abusive tax shelters where the shelters are designed, marketed, and undertaken solely to create tax benefits unintended by the tax laws. Congress has also introduced proposed legislation to severely punish promoters and participants in abusive tax shelters.

IRS Settlement Initiative: Over the past five years, the IRS has begun publishing notices identifying certain generic tax shelters as “potentially abusive” and warning taxpayers that the use of such “listed transactions” may lead to an audit and assessment of back taxes, interest, and penalties. “Potentially abusive” tax shelters are those that come within the scope of “listed transactions,” and “illegal shelters” are those with respect to which the IRS has taken actual enforcement action against taxpayers for violating federal law.

The IRS is currently offering a settlement initiative for the “listed transaction” entitled the “Son of Boss” (Bond Option Sales Strategy), where investors in such shelter have an opportunity to quickly close out their tax disputes. Under its terms, eligible taxpayers must apply to the IRS by June 21, 2004, and concede 100 percent of the claimed artificial tax losses created by false basis adjustments. In exchange for the concession, taxpayers will be allowed to treat as a loss their out-of-pocket transaction costs, such as promoter and professional fees, and eliminate or reduce penalties. *See IR-2004-64.*

DRS Compliance Initiative: DRS will be administering a compliance initiative through July 31, 2004, for all taxpayers that have participated in **any** “potentially abusive” tax shelter designated by the IRS as a “listed transaction.” For purposes of this Announcement, a “listed transaction” is a transaction that is the same as, or substantially similar to, one identified by the IRS under I.R.C. §6011 and the Treasury Regulations thereunder, whether or not (a) the IRS had identified the transaction as a “listed transaction” at the time the taxpayer entered into the transaction, or (b) the transaction is (or was) required to be disclosed by the taxpayer as a “listed transaction” according to the Treasury Regulations (including the temporary regulations) under I.R.C. §6011.

Terms of the Compliance Initiative:

- (1) Taxpayers must concede (a) 100 percent of the claimed artificial tax loss created by a false basis adjustment, or (b) any other gain mitigation strategy (such as S Corporation Tax Shelters (SC2s) or I.R.C. §401(k) Accelerators) used to shelter income. See *IRS Notice 2004-30*; *Rev. Rul. 2002-46*.
- (2) Interest on the underpayment of tax will be imposed until the taxpayer makes full payment of the liabilities. The filing of the election to participate described below does not suspend the accrual of interest on the underpayment.
- (3) Cost and fees associated with the establishment of an abusive tax shelter may be deducted for Connecticut tax purposes, to the extent they are allowed by the IRS.
- (4) In exchange for coming forward, DRS will not impose civil penalties and will not pursue criminal prosecution for the taxpayer's participation in a tax shelter.

Required Procedures:

- (1) **Participation Election.** Taxpayers participating in this initiative must notify DRS of their election by sending **Form CT-ATS, Election to Participate in the Connecticut Abusive Tax Shelter Compliance Initiative**, on or before **July 31, 2004** to:

**Department of Revenue Services
Abusive Tax Shelter Compliance Unit
Audit Division
25 Sigourney Street
Hartford, CT 06106**

- (2) **Additional Information.** Upon receipt and review of the notice to participate, DRS will mail a notice of acknowledgment to the taxpayer listing the documentation and additional information needed from the taxpayer. After receiving the notice of acknowledgment, the taxpayer must submit to DRS on or before September 30, 2004, all information and documentation relevant to the tax shelter and any additional information requested by the Audit Division. This information will allow DRS to calculate the additional taxes and interest due as a result of the taxpayer's participation in the

compliance initiative. DRS may grant additional time for this process if good cause is shown.

Closing Agreement and Payment: After receipt of the taxpayer's requested information and documentation, DRS will prepare a Closing Agreement under Conn. Gen. Stat. §12-2e reflecting the terms of the compliance initiative. The Closing Agreement will also provide that taxpayers may not file a claim for refund or receive a credit for the amounts paid (including interest) under the compliance initiative in connection with their participation in a "listed transaction." Additionally, taxpayers may not appeal any issue that relates to or may affect the amounts paid (including interest) under this compliance initiative in connection with their participation in a "listed transaction."

Subsequent to drafting the Closing Agreement, DRS will mail the document to the taxpayer. The taxpayer must sign the Closing Agreement and return it to DRS with full payment of liabilities within 30 days of the date of mailing by DRS. Once full payment is received, DRS will sign and execute the Closing Agreement and a copy of such agreement will be sent to the taxpayer. If full payment is not timely made to DRS, the taxpayer will be ineligible to participate in this compliance initiative. DRS may grant an extension of payment for good cause to taxpayers who request additional time within the 30 day period.

Enforcement: DRS will target and aggressively pursue any taxpayer that has engaged in a "listed transaction" to shelter income and that does not come forward to participate in this settlement initiative. DRS will impose the most severe penalties available under the law against such taxpayers.

To find participants in abusive tax shelters, DRS is methodically reviewing and examining the public subpoenaed information uncovered by the United States Senate Permanent Subcommittee on Investigations and is working in conjunction with the IRS to exchange information. Also, Connecticut is one of many states, including California and New York, to sign a joint agreement to share information on abusive tax shelters and illegal transactions. The agreement was facilitated by the Federation of Tax Administrators (FTA) and is intended to provide a formal structure for the states to cooperate with each other when a shelter is uncovered. Information between the states is already being shared.

Effect on Other Documents: None.

Effect of This Document: Announcements alert taxpayers to new developments (other than newly enacted or amended Connecticut or federal laws or newly released judicial decisions), including new administrative positions, policies, or practices.

For Further Information: Call DRS during business hours, Monday through Friday:

- **1-800-382-9463** (in-state), or
- **860-297-5962** (from anywhere)

TTY, TDD, and Text Telephone users only may transmit inquiries anytime by calling 860-297-4911.

Forms and Publications: Forms and publications are available anytime by:

- **Internet:** Preview and download forms and publications from the DRS Web site at www.ct.gov/DRS
 - **DRS TAX-FAX:** Call **860-297-5698** from the handset attached to your fax machine and select from the menu. (Only forms (not publications) are available on TAX-FAX.)
 - **Telephone:** Call **860-297-4753** (from anywhere), or **1-800-382-9463** (in-state) and select **Option 2** from a touch-tone phone.
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Paperless Filing Methods (fast, easy, free, and confidential):

- **For business returns:** Use *Fast-File* to file sales and use taxes, business use tax, room occupancy tax, or withholding tax returns over the Internet or telephone. Visit the DRS Web site at www.ct.gov/DRS and click on *File Returns On-Line* or call **860-947-1988**.
 - **For resident income tax returns:** Use *WebFile* to file personal income tax returns over the Internet. Visit the DRS Web site at www.ct.gov/DRS and click on *File Returns On-Line*.
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