

defined in § 1.6011-4(b) or § 1.6011-4T(b), as applicable) contrary to a revenue ruling or notice has not disregarded the ruling or notice if the contrary position has a realistic possibility of being sustained on its merits.

(c) No penalty under section 6662(b)(1) may be imposed on any portion of an underpayment that is attributable to a position contrary to a rule or regulation if the position is disclosed in accordance with the rules of paragraph (c)(2) of this section (and, if the position relates to a reportable transaction as defined in § 1.6011-4(b) (or § 1.6011-4T(b), as applicable), the transaction is disclosed in accordance with § 1.6011-4 (or § 1.6011-4T, as applicable)) and, in case of a position contrary to a regulation, the position represents a good faith challenge to the validity of the regulation.

**§ 1.6662-4 [Amended]**

- 5. Section 1.6662-4(g)(1)(iv) is amended by removing the reference to “§ 1.6664-4(e)” and adding the reference “§ 1.6664-4(f)” in its place.
- 6. Section 1.6664-0 is amended by:
  - 1. Adding entries for § 1.6664-1 (b)(2)(i), (b)(2)(ii) and 1.6664-4(c)(1)(iii).
  - 2. Redesignating the entries for § 1.6664-4(d), (e), (f), and (g), as § 1.6664-4(e), (f), (g), and (h), respectively.
  - 3. Adding a new entry for § 1.6664-4(d).

The additions read as follows:

**§ 1.6664-0 Table of contents.**

**§ 1.6664-1 Accuracy-related and fraud penalties, definitions and special rules.**

- (b) (1) For returns due after September 1, 1995.
- (b) (2) (i) For returns filed after December 31, 2002.

**§ 1.6664-4 Reasonable cause and good faith exception to section 6662 penalties.**

- (c) (iii) Reliance on the invalidity of a regulation.
- (d) Underpayments attributable to reportable transactions.

- 7. Section 1.6664-1 is amended by:
  - 1. Redesignating the text of paragraph (b)(2) as (b)(2)(i).
  - 2. Adding a new paragraph heading for newly designated paragraph (b)(2)(i).
  - 3. Adding paragraph (b)(2)(ii).

The revisions and additions are as follows:

**§ 1.6664-1 Accuracy-related and fraud penalties; definitions and special rules.**

- (b) (1) For returns due after September 1, 1995.
- (b) (2) (i) For returns filed after December 31, 2002. Sections 1.6664-4(c) (relating to relying on opinion or advice) and (d) (relating to underpayments attributable to reportable transactions) apply to returns filed after December 31, 2002, with respect to transactions entered into on or after January 1, 2003. Except as provided in paragraph (b)(2)(i) of this section, § 1.6664-4 (as contained in 26 CFR part 1 revised April 1, 2003) applies to returns filed with respect to transactions entered into before January 1, 2003.

- 8. Section 1.6664-4 is amended by:
  - 1. Removing the language “(g) of this section” from the last sentence of paragraph (a) and adding the language “(h) of this section” in its place.
  - 2. Revising paragraph (c)(1) introductory text and the last sentence of paragraph (c)(1)(i).
  - 3. Adding paragraph (c)(1)(iii).
  - 4. Redesignating paragraphs (d), (e), (f) and (g) as paragraphs (e), (f), (g) and (h), respectively.
  - 5. Adding a new paragraph (d).
  - 6. Removing the language “(e)” wherever it appears in newly designated paragraphs (f)(1), (f)(2)(i), (f)(2)(ii), (f)(3), and (f)(4) and adding the language “(f)” in its place.
  - 7. Removing the language “(g)” wherever it appears in newly designated paragraphs (h)(1), (h)(1)(i), (h)(2), and (h)(3) and adding the language “(h)” in its place.

The revisions and additions read as follows:

**§ 1.6664-4 Reasonable cause and good faith exception to section 6662 penalties.**

(c) *Reliance on opinion or advice*—(1) *Facts and circumstances; minimum requirements.* All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor) as to the treatment of the taxpayer (or any entity, plan, or arrangement) under Federal tax law. For example, the taxpayer’s education, sophistication and business experience will be relevant in determining whether the taxpayer’s reliance on tax advice was reasonable and made in good faith. In no event will a taxpayer be considered to have

reasonably relied in good faith on advice (including an opinion) unless the requirements of this paragraph (c)(1) are satisfied. The fact that these requirements are satisfied, however, will not necessarily establish that the taxpayer reasonably relied on the advice (including the opinion of a tax advisor) in good faith. For example, reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.

(i) In addition, the requirements of this paragraph (c)(1) are not satisfied if the taxpayer fails to disclose a fact that it knows, or reasonably should know, to be relevant to the proper tax treatment of an item.

(iii) *Reliance on the invalidity of a regulation.* A taxpayer may not rely on an opinion or advice that a regulation is invalid to establish that the taxpayer acted with reasonable cause and good faith unless the taxpayer adequately disclosed, in accordance with § 1.6662-3(c)(2), the position that the regulation in question is invalid.

(d) *Underpayments attributable to reportable transactions.* If any portion of an underpayment is attributable to a reportable transaction, as defined in § 1.6011-4(b) (or § 1.6011-4T(b), as applicable), then failure by the taxpayer to disclose the transaction in accordance with § 1.6011-4 (or § 1.6011-4T, as applicable) is a strong indication that the taxpayer did not act in good faith with respect to the portion of the underpayment attributable to the reportable transaction.

**Mark E. Matthews,**

*Deputy Commissioner for Services and Enforcement.*

Approved: December 18, 2003.

**Pamela F. Olson,**

*Assistant Secretary of the Treasury.*

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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Parts 1 and 301**

**[TD 9108]**

**RIN 1545-BC76**

**Confidential Transactions**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** These final regulations modify and clarify the rules relating to confidential transactions under the Income Tax Regulations, and make minor conforming changes to the list maintenance rules under the Procedure and Administration Regulations. These regulations affect taxpayers participating in reportable transactions and persons responsible for maintaining and furnishing lists of investors in reportable transactions.

**DATES:** *Effective Date:* These regulations are effective December 29, 2003.

*Applicability Dates:* For dates of applicability, see § 1.6011-4(h) and § 301.6112-1.

**FOR FURTHER INFORMATION CONTACT:** Tara P. Volungis or Charlotte Chyr, 202-622-3070 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Paperwork Reduction Act**

The collections of information contained in these regulations have been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control numbers 1545-1685 and 1545-1686.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

**Background**

This document amends 26 CFR parts 1 and 301 by modifying and clarifying the rules relating to the disclosure of reportable transactions by certain taxpayers on their Federal income tax returns under section 6011 and by making conforming changes to the rules under section 6112.

On October 17, 2002, the IRS issued temporary and proposed regulations modifying the rules under sections 6011, 6111, and 6112 (TD 9017, REG-103735-00, REG-154117-02, REG-154116-02, REG-154115-02, REG-154429-02, REG-154423-02, REG-154426-02, REG-110311-98; TD 9018, REG-103736-00) (the October 2002 regulations). The October 2002 regulations were published in the *Federal Register* (67 FR 64799, 67 FR

64840; 67 FR 64807, 67 FR 64842) on October 22, 2002. On December 11, 2002, and on January 7, 2003, the IRS and Treasury Department held a public hearing on these regulations. On February 28, 2003, the IRS issued final regulations under sections 6011, 6111, and 6112 (TD 9046) (the February 2003 regulations). The February 2003 regulations were published in the *Federal Register* (68 FR 10161) on March 4, 2003.

Since finalizing the disclosure regulations, the IRS and Treasury Department have received numerous comments concerning the confidentiality filter. The IRS and Treasury Department received requests to exclude certain transactions from the scope of the confidentiality filter, and requests to modify the language of the regulation itself. After reviewing these comments, the IRS and Treasury Department have decided to narrow the confidentiality filter under § 1.6011-4(b)(3).

**Explanation of Provisions**

Section 1.6011-4(b)(3) provides that certain transactions are identified as confidential transactions. Confidential transactions are reportable transactions that are subject to the disclosure rules under § 1.6011-4 and the list maintenance rules under § 301.6112-1. Currently, a confidential transaction is a transaction that is offered under conditions of confidentiality. The confidentiality filter generally provides a presumption of non-confidentiality if the taxpayer receives written authorization to disclose the tax treatment and tax structure of the transaction.

The IRS and Treasury Department have concluded that the confidentiality filter should be limited to situations in which an advisor is paid a large fee and imposes a limitation on disclosure that protects the confidentiality of the advisor's tax strategies. The IRS and Treasury Department believe that the confidentiality filter should not apply to transactions in which confidentiality is imposed by a party to the transaction acting in such capacity. Accordingly, the confidentiality filter has been narrowed to reflect this policy. Further, the exceptions and presumption language have been removed because the IRS and Treasury Department have concluded that they no longer are necessary under this narrower rule. Conforming changes have been made to the rules under § 301.6112-1.

The IRS and Treasury Department also have made minor clarifying changes under § 1.6011-4. The regulations clarify that a return includes

amended returns for purposes of determining when a disclosure must be made. The IRS and Treasury Department will continue to accept comments and will make other changes as appropriate.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined pursuant to 5 U.S.C. 553(b)(B) that notice and public procedure are unnecessary and contrary to the public interest. These final regulations substantially reduce taxpayer compliance burdens by limiting the scope of transactions subject to the disclosure requirements of § 1.6011-4. For the same reason, pursuant to 5 U.S.C. 553(d)(1) and (3) a delayed effective date for these final regulations is not required. Because no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. However, the IRS and Treasury Department welcome comments on whether these final regulations impose additional costs and compliance burdens on small businesses. Any such comments should provide specific information concerning those costs and burdens. In addition, the IRS and Treasury Department will consider holding a public hearing concerning these regulations if there is sufficient interest from affected parties. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

**Drafting Information**

The principal authors of these regulations are Tara P. Volungis and Charlotte Chyr, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

**List of Subjects**

*26 CFR Part 1*

Income taxes, Reporting and recordkeeping requirements.

*26 CFR Part 301*

Administrative practice and procedure, Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

**Adoption of Amendments to the Regulations**

■ Accordingly, 26 CFR parts 1 and 301 are amended as follows:

**PART 1—INCOME TAXES**

■ 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

■ 2. Section 1.6011-4 is amended as follows:

- 1. Paragraph (b)(3) is revised.
- 2. Paragraph (e)(1) is amended by removing the second sentence and adding two new sentences in its place.
- 3. Paragraphs (e)(2)(i) and (h) are revised.

The revisions and additions read as follows:

**§ 1.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.**

\* \* \* \* \*

(b) \* \* \*

(3) *Confidential transactions*—(i) *In general.* A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee.

(ii) *Conditions of confidentiality.* A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction.

(iii) *Minimum fee.* For purposes of this paragraph (b)(3), the minimum fee is:

- (A) \$250,000 for a transaction if the taxpayer is a corporation.
- (B) \$50,000 for all other transactions unless the taxpayer is a partnership or trust, all of the owners or beneficiaries of which are corporations (looking through any partners or beneficiaries that are themselves partnerships or trusts), in which case the minimum fee is \$250,000.

(iv) *Determination of minimum fee.* For purposes of this paragraph (b)(3), a minimum fee includes all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction. These fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent that the fees exceed the fees customary for return preparation. For purposes of this paragraph (b)(3), a taxpayer also is treated as paying fees to an advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the advisor, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property.

(v) *Related parties.* For purposes of this paragraph (b)(3), persons who bear a relationship to each other as described in section 267(b) or 707(b) will be treated as the same person.

(e) \* \* \*

(1) \* \* \* In addition, the disclosure statement for a reportable transaction must be attached to each amended return that reflects a taxpayer's participation in a reportable transaction. A copy of the disclosure statement must be sent to OTSA at the same time that any disclosure statement is first filed by the taxpayer. \* \* \*

(2) \* \* \*

(i) *Listed transactions.* If a transaction becomes a listed transaction after the filing of a taxpayer's tax return (including an amended return) reflecting either tax consequences or a tax strategy described in the published guidance listing the transaction (or a tax benefit derived from tax consequences or a tax strategy described in the published guidance listing the transaction) and before the end of the period of limitations for the final return (whether or not already filed) reflecting the tax consequences, tax strategy, or tax benefit, then a disclosure statement must be filed as an attachment to the taxpayer's tax return next filed after the date the transaction is listed regardless

of whether the taxpayer participated in the transaction in that year.

\* \* \* \* \*

(h) *Effective dates.* This section applies to Federal income tax returns filed after February 28, 2000. However, paragraphs (b)(3), (e)(1), and (e)(2)(i) of this section apply to transactions entered into on or after December 29, 2003. All the rules in this section may be relied upon for transactions entered into on or after January 1, 2003, and before December 29, 2003. Otherwise, the rules that apply with respect to transactions entered into before December 29, 2003, are contained in § 1.6011-4 in effect prior to December 29, 2003, (see 26 CFR part 1 revised as of April 1, 2003).

**PART 301—PROCEDURE AND ADMINISTRATION**

■ 3. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

■ 4. § 301.6112-1, paragraph (c)(3)(iii) is amended by revising the first sentence, removing the language "for advice or implementation" from the third sentence, and adding two sentences after the third sentence, to read as follows:

**§ 301.6112-1 Requirement to prepare, maintain, and furnish lists with respect to potentially abusive tax shelters.**

\* \* \* \* \*

(c) \* \* \*

(3) \* \* \*

(iii) \* \* \* In determining whether the minimum fee threshold is satisfied, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction that is a potentially abusive tax shelter are taken into account. \* \* \* A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property. \* \* \*

\* \* \* \* \*

**Mark E. Matthews,**  
*Deputy Commissioner for Services and Enforcement.*

Approved: December 18, 2003.

**Pamela F. Olson,**  
*Assistant Secretary of the Treasury.*  
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