

Part IV - Items of General Interest

Settlement Initiative

Announcement 2005-80

Section 1. Overview

This announcement provides a settlement initiative under which taxpayers and the Internal Revenue Service (Service) may resolve the tax treatment of certain tax transactions. Section 2 describes who is eligible to participate. Section 3 describes eligible transactions. Section 4 describes the settlement terms. Section 5 sets out the settlement procedures. Taxpayers have until January 23, 2006, to notify the Service of their intent to participate in this settlement initiative.

Section 2. Eligible Taxpayers

A person that claimed a federal tax benefit from a transaction described in section 3, including a person that filed an amended return claiming a federal tax benefit from such a transaction, may participate in this initiative unless the person is an ineligible person as determined in this section. However, a person described in paragraph 1, 2, or 3 that would like to settle under this initiative may file an Election that identifies each reason the person is an ineligible person, and request that the Service permit settlement under this initiative.

1. Promoters. A person who (i) organized, managed or sold the transaction; (ii) participated in the organization, management, or sale of the transaction; or (iii) received fees in connection with the organization, management, or sale of the transaction is an ineligible person.
2. Persons related to promoters. A partner in a partnership that is described in paragraph 1 of this section, a five percent or more shareholder of a corporation that is described in paragraph 1, or a person otherwise related to a person described in paragraph 1 within the meaning of § 267(b) (other than § 267(b)(1)) or § 707(b) is an ineligible person.
3. TEFRA partners of promoters. A partner in a disqualified entity in which (a) an ineligible partner claimed more than two percent of the improper tax benefits from the transaction at issue, or (b) ineligible partners in the aggregate claimed five percent or more of the improper tax benefits from the transaction, is an ineligible person. An “ineligible partner” is a person who is an ineligible person other than

by reason of this paragraph 3. A “disqualified entity” is an entity that (i) is subject to the unified partnership audit and litigation provisions of §§ 6221 through 6234, as enacted by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA partnership), (ii) engaged in a transaction described in section 3 of this announcement, and (iii) includes one or more ineligible partners. However, a partner who is not an ineligible partner may settle if the ineligible partners that cause the TEFRA partnership to be described in this paragraph 3 execute a waiver under § 6224(b) of their right under § 6224(c)(2) to a consistent settlement agreement, as provided in Form 13751, *Waiver of Right to Consistent Agreement of Partnership Items and Partner-level Determinations as to Penalties, Additions to Tax, and Additional Amounts*.

4. Persons who engaged in a transaction that has been designated for litigation. A person who directly or indirectly engaged in a transaction and, before the date on which the Election is filed, the Service has informed the person (or the tax matters partner or notice group of the TEFRA partnership of which the person was a partner) that the Service has designated or is considering designating the transaction for litigation is an ineligible person.
5. Persons in litigation. A person who, individually or as a partner in a TEFRA partnership, is a party in a court proceeding to determine the tax treatment of any aspect of the transaction is an ineligible person.
6. Fraud. A person against whom the Service has imposed the fraud penalty under § 6663, or a person that has been notified before the date on which the Election is filed that the Service is considering imposing the fraud penalty against that person, is an ineligible person.
7. Persons under criminal investigation. A person under tax-related criminal investigation by the Service or the Department of Justice, or a person that has been notified, before the date on which the Election is filed, that the Service or the Department of Justice intends to commence a tax-related criminal investigation of that person is an ineligible person.

Section 3. Eligible Transactions

The following transactions are eligible for settlement under this initiative. Stated by each transaction is the accuracy-related penalty on the underpayment attributable to the transaction that a person will be required to pay, unless one of the exceptions listed in paragraph E of section 4 applies.

1. Notice 2002-21, 2002-1 C.B. 730 (Tax Avoidance Using Inflated Basis) (20%).
2. Notice 2001-16, 2001-1 C.B. 730 (Intermediary Transactions Tax Shelter) (20%).
3. Notice 2003-55, 2003-2 C.B. 395 (Accounting for Lease Strips and Other Stripping Transactions (10%), and transactions involving losses reported from inflated basis assets from lease strips (20%)).
4. Notice 2003-54, 2003-2 C.B. 363 (Common Trust Fund Straddle Tax Shelters) (10%), but excluding transactions described in Notice 2002-50, 2002-1 C.B. 992, and Notice 2002-65, 2002-2 C.B. 690.

5. Notice 2003-81, 2003-2 C.B. 1223 (Tax Avoidance Using Offsetting Foreign Currency Option Contracts) (10%).
6. Notice 99-59, 1999-2 C.B. 761 (Tax Avoidance Using Distributions of Encumbered Property) (10%).
7. Rev. Rul. 2004-98, 2004-42 I.R.B. 664 ("Reimbursements" for parking expenses previously paid by an employer or previously paid by an employee through salary reduction) (5%).
8. Rev. Rul. 2004-20, 2004-1 C.B. 546, Situation 1 (Pension plan fails to satisfy § 412(i) where amounts accumulated under life insurance contracts and annuities held by the plan exceed benefits payable under plan terms) and Situation 2 (Employer contributions to pension plan are not currently deductible when used to pay premiums on life insurance contracts that provide for death benefits in excess of the participant's death benefit under the terms of the plan), and Rev. Rul. 2004-21, 2004-1 C.B. 544 (Pension plan fails to satisfy nondiscrimination requirements due to differences in the value of participants' rights to purchase life insurance contracts from the plan) (5%).
9. Notice 2004-8, 2004-1 C.B. 333 (Abusive Roth IRA Transactions) (5%).
10. Rev. Rul. 2004-4, 2004-1 C.B. 414 (Transactions that involve segregating the business profits of an employee stock ownership plan (ESOP)-owned S corporation in a qualified subchapter S subsidiary, so that rank-and-file employees do not benefit from participation in the ESOP) (5%).
11. Notice 2003-77, 2003-2 C.B. 1182 (Transfers to Trusts to Provide for the Satisfaction of Contested Liabilities) (5%).
12. Notice 2003-24, 2003-1 C.B. 853 (Tax Problems Raised by Certain Trust Arrangements Seeking to Qualify for Exception for Collectively Bargained Welfare Benefit Funds under § 419A(f)(5)) (5%).
13. Rev. Rul. 2003-6, 2003-1 C.B. 286 (Certain arrangements involving the transfer of ESOPs that hold stock in an S corporation for the purpose of claiming eligibility for the delayed effective date of § 409(p)) (5%).
14. Rev. Rul. 2002-3, 2002-1 C.B. 316; Rev. Rul. 2002-80, 2002-2 C.B. 925 ("Reimbursements" of employees for salary reduction amounts previously excluded from gross income under § 106; "Advance reimbursements" or "loans" without regard to whether an employee has incurred medical expenses) (5%).
15. Notice 2000-60, 2000-2 C.B. 568 (Stock Compensation Corporate Tax Shelter) (5%).
16. Rev. Rul. 2000-12, 2000-1 C.B. 744 (Certain transactions involving the acquisition of two debt instruments the values of which are expected to change significantly at about the same time in opposite directions) (5%).
17. Notice 95-34, 1995-1 C.B. 309 (Tax Problems Raised by Certain Trust Arrangements Seeking to Qualify for Exemption from § 419) (5%).
18. Treas. Reg. § 1.643(a)-8 (Certain Distributions by Charitable Remainder Trusts) (5%).
19. Certain abusive charitable contributions and conservation easements (Deductions under § 170 improperly claimed as a result of: (a) open space easements where the easement has no, or de minimis, value; (b) historic land or façade easements that have no, or de minimis, value; and (c) so-called

conservation buyer transactions where the charitable organization purchases property, places an easement on it and then “sells” the property with the easement to a buyer at a price substantially less than that paid for it and the buyer also makes a charitable contribution that approximates the price differential. See Notice 2004-41, 2004-28 I.R.B. 31.) (5%).¹

20. Certain abusive charitable contributions of patents and other intellectual property (Transfers of patents or other intellectual property to charitable organizations where the property transferred has no, or de minimis, value. See Notice 2004-7, 2004-1 C.B. 310.) (5%).¹
21. Management S Corporation ESOP Transactions (Transactions where the taxpayer has claimed that it is entitled to exclude income of an operating business by asserting, incorrectly, that the taxpayer had established, on or before March 14, 2001, an employee stock ownership plan entitled to an exemption from unrelated business income and an S corporation that is a management corporation, and whatever actions that were taken to attempt to establish an employee stock ownership plan and a management S corporation were taken on or before March 14, 2001) (5%).

Section 4. Settlement Terms

A. General Tax Adjustments.

The Service will settle with persons under this initiative by disallowing the improperly claimed tax benefits associated with the transaction in a manner consistent with relevant published guidance providing the Service’s view of the transaction, the terms set forth in this announcement, and the facts and circumstances surrounding the specific transaction. For certain transactions, that may mean that the transaction will be treated as not having occurred for tax purposes and the person must concede all claimed tax benefits of the transaction for all taxable periods not barred by the period of limitations on assessment. For other transactions, that may mean that the transaction will be recharacterized in a manner consistent with its substance, and the person must concede all claimed tax benefits inconsistent with that substance. The person may also be required to make adjustments to basis, as appropriate, may be required to unwind or dissolve entities formed for the purpose of facilitating the transaction, and may have to pay applicable excise tax, employment tax, and self-employment tax liabilities.

These settlement terms apply for resolution of these transactions only, and do not constitute an interpretation of general rules to be applied in transactions not settled

¹ The Service does not consider deductions under § 170 for charitable contributions of patents, other intellectual property, or conservation easements to be inappropriate when taxpayers have complied with the requirements for such deductions. Indeed, § 170 is intended to encourage charitable giving. In some instances, however, taxpayers have improperly claimed charitable contribution deductions as described in Notice 2004-41 and Notice 2004-7.

under this initiative.

A person may be required to change its method(s) of accounting to resolve a transaction. In such a situation, the settlement will impose the necessary accounting method change(s) with the following terms and conditions. The year of change will be the earliest taxable year in which the existing accounting method was used by the person in connection with the transaction, or the first taxable year for which the period of limitations has not expired. The Commissioner will grant consent under § 446(e) to make the method change on a retroactive basis. Where required, a § 481(a) adjustment will be imposed and taken into account entirely in the year of change.

Additional transaction-specific provisions apply in resolving these transactions. See Questions and Answers for Announcement 2005-80 at <http://www.irs.gov> for those specific provisions.

B. Transaction Costs Generally Allowed as an Ordinary Loss. A person settling under this initiative will be allowed to treat as an ordinary loss those transaction costs, including promoter fees and fees paid for accounting, appraisal, and legal services, actually paid by the taxpayer. If tax benefits, including benefits attributable to transaction costs, were claimed in a year barred by the period of limitations on assessment, then transaction costs will be allowed as an ordinary loss only to the extent the transaction costs exceed the tax benefits claimed in the barred years.

C. Tax-Exempt Entities. Where a transaction includes a tax-exempt entity as a party, resolution for the taxpayer may require the tax-exempt entity to disburse any funds received as a result of the transaction. As noted in paragraph A of this section 4, excise taxes may also apply. If an eligible taxpayer created a tax-exempt entity specifically for the purpose of accommodating an abusive or tax-avoidance transaction, or if an entity created by an eligible taxpayer has engaged in abusive transactions as a substantial part of its activities, the entity may also be required to agree to revocation of its exemption.

D. Multi-Party Transactions. The Service generally expects that all parties to a transaction (e.g., an employer and employee) will elect to resolve the transaction under this initiative. The failure of all parties to the transaction to elect to resolve the transaction under this initiative will not automatically preclude settlement for the electing parties. If all parties do not elect to participate in this initiative, however, the Service reserves the right to not settle with the electing parties if it is not in the interest of sound tax administration to do so.

E. Penalties.

1. Except as otherwise provided in this paragraph E, a person that settles a transaction under this initiative will pay an accuracy-related penalty under § 6662 on the underpayment attributable to the transaction in the percentage amount provided for the transaction above in section 3.

2. A person that properly disclosed the transaction under Announcement 2002-2, 2002-1 C.B. 304, will not pay a penalty on the underpayment attributable to the disclosed transaction.
3. For purposes of this settlement initiative, at the discretion of the Service, a person that received and relied on a written tax opinion with respect to the treatment of the transaction under federal tax law before filing a return affected by the transaction will not pay a penalty on the underpayment attributable to that transaction if²—
 - a. the tax opinion (i) concluded at a confidence level of at least “more likely than not” (a greater than 50% likelihood) that all significant federal tax issues arising out of the transaction would be resolved in the taxpayer’s favor, and (ii) considered all the relevant facts and did not assume any unreasonable facts; and
 - b. the tax advisor (i) was not a person described in section 2, paragraph 1 or 2, (ii) was not referred to the taxpayer by a person described in section 2, paragraph 1 or 2, and (iii) did not have a fee arrangement contingent on the successful sustention of all or part of the intended tax benefit.
4. All other applicable penalties and additions to tax will apply.

F. Statute Extensions. Where the period of limitations on assessment of any applicable tax (e.g., income, excise, and employment taxes) will otherwise expire within 12 months after a person files an Election, the Service will ordinarily request that the person consent to extend the applicable period of limitations. If, after a request by the Service, the person does not consent to extend the applicable period of limitations as requested, the Service will treat that person as having withdrawn from this initiative.

Section 5. Application Process

A. Election. A person that wants to resolve a transaction through this settlement initiative must send an Election (Form 13750, *Election to Participate in Announcement 2005-80 Settlement Initiative*, and all required attachments) on or before January 23, 2006, to:

INTERNAL REVENUE SERVICE
Attn: Announcement 2005-80
MS 1505
24000 Avila Rd
Laguna Niguel, CA 92677

Form 13750, as well as the required schedules and attachments, must be used to elect to participate in this initiative and must be submitted to the address listed above. The

² The penalty waiver under this paragraph is being provided in the context of this administrative settlement, and does not reflect all relevant facts and circumstances that determine whether a taxpayer reasonably relied in good faith on a tax opinion.

form will be available at <http://www.irs.gov>. The Service reserves the right not to accept any Election not properly addressed and timely mailed within the meaning of § 7502.

A person who is under examination (or in Appeals), or who is a partner in a TEFRA partnership that is under examination (or in Appeals), must send a copy of the Election to the IRS examiner (or IRS Appeals Officer).

B. Required Information. The Election requests information necessary to process the election and determine the proper tax liabilities. The Service may request additional information and documents relating to the transaction, such as marketing materials and tax opinion letters. All requested information must be submitted under penalties of perjury to the Service within 30 days of the date of mailing of the request for additional information by the Service. The Service may grant an extension for good cause to persons who request additional time within the 30-day period. The Service will treat a person who fails to provide the required information within the applicable time period as having withdrawn from the initiative.

C. Passthrough Entities. If the participant in the transaction was a partnership, subchapter S corporation, or some other pass-through entity, then the person that would be liable for the tax (e.g., the partner or shareholder) who wants to participate in this initiative must submit an Election on his or her own behalf.

D. Closing Agreement and Payment. After receiving all the necessary information, the Service will prepare a closing agreement under § 7121 reflecting the terms of the settlement. The Service will send the closing agreement to the person (or the person's corporate parent or representative, if appropriate), who must sign and return it to the Service within 30 days of the date of mailing by the Service. The Service may grant an extension for good cause.

A person settling under this initiative must fully pay all taxes, interest, and penalties due under the terms of the settlement when the signed closing agreement is returned to the Service. Any person unable to make full payment at that time must submit complete financial statements and agree to financial arrangements acceptable to the Service before the Service will execute a closing agreement. The Service will not execute a closing agreement under this initiative with anyone unable to reach acceptable financial arrangements.

E. Other Dispute Resolution Procedures. This settlement initiative does not affect conventional Service resolution procedures available to eligible persons that do not settle under this initiative. For eligible persons that forgo resolving eligible transactions under this settlement initiative and take their issues to Appeals, Appeals will carefully consider both the issue merits and the penalty, but such persons should not expect to receive a better offer in Appeals than that offered under this settlement initiative and may in fact receive a less favorable outcome.

Section 6. Paperwork Reduction Act

The collection of information in this announcement has been reviewed and approved by the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545-1967. 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 number.

The collection of information in this announcement is in Section 5, Application Process. This information is required to apply the terms of the settlement and determine the suitable amount of any penalties. Collecting information is required to obtain the benefit described in this announcement. The likely respondents are individuals, businesses, other for-profit institutions, and tax-exempt entities.

The estimated total annual reporting burden is 2,500 hours. The estimated annual burden per respondent varies from 3 to 7 hours, depending on individual circumstances, with an estimated average of 5 hours. The estimated number of respondents is 500. The estimated frequency of responses is one time per respondent.

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

Section 7. Contact Information

The principal author of this announcement is Joe Spires of the Office of Chief Counsel. For further information regarding this announcement, questions can be sent to Settlement.Initiative@irs.counsel.treas.gov or contact (202) 622-4284 (not a toll-free call).