



**Section of Taxation**

Suite 400  
1050 Connecticut Avenue, NW  
Washington, DC 20036  
202-662-8670  
FAX: 202-662-8682  
E-mail: tax@americanbar.org

July 9, 2013

Mr. Daniel Werfel  
Principal Deputy Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20024

Re: Comments Concerning Proposed Treasury Regulations Under Section 6708

Dear Principal Deputy Commissioner Werfel:

Enclosed are comments concerning proposed Treasury regulations under section 6708. These comments represent the view of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Rudolph R. Ramelli  
Chair

Enclosure

cc: Mark J. Mazur, Assistant Secretary (Tax Policy), Department of the Treasury  
William J. Wilkins, Chief Counsel, Internal Revenue Service  
Emily S. McMahon, Deputy Assistant Secretary (Tax Policy), Department of  
Treasury

OFFICERS  
*Chair*  
Rudolph R. Ramelli  
New Orleans, LA  
*Chair-Elect*  
Michael Hirschfeld  
New York, NY  
*Vice Chairs*  
*Administration*  
Leslie E. Grodd  
Westport, CT  
*Committee Operations*  
Priscilla E. Ryan  
Chicago, IL  
*Continuing Legal Education*  
William H. Caudill  
Houston, TX  
*Government Relations*  
Eric Solomon  
Washington, DC  
*Pro Bono and Outreach*  
John P. Barrie  
New York, NY  
*Publications*  
Alice G. Abreu  
Philadelphia, PA  
*Secretary*  
Megan L. Brackney  
New York, NY  
*Assistant Secretary*  
Thomas D. Greenaway  
Boston, MA  
  
COUNCIL  
*Section Delegates to the*  
*House of Delegates*  
Richard M. Lipton  
Chicago, IL  
Susan P. Serota  
New York, NY  
*Last Retiring Chair*  
William M. Paul  
Washington, DC  
*Members*  
Michael A. Clark  
Chicago, IL  
Julian Kim  
Washington, DC  
Mary Ann Mancini  
Washington, DC  
Mary A. McNulty  
Dallas, TX  
Steven M. Rosenthal  
Washington, DC  
Pamela Baker  
Chicago, IL  
W. Curtis Elliott, Jr.  
Charlotte, NC  
Scott D. Michel  
Washington, DC  
Eric B. Sloan  
New York, NY  
Brian P. Trauman  
New York, NY  
Jody J. Brewster  
Washington, DC  
Julie Divola  
San Francisco, CA  
Fred F. Murray  
Washington, DC  
Charles Rettig  
Beverly Hills, CA  
Bahar Schippel  
Phoenix, AZ  
  
LIAISONS  
*Board of Governors*  
Allen C. Goolsby, III  
Richmond, VA  
*Young Lawyers Division*  
Travis Greaves  
Washington, DC  
*Law Student Division*  
Tuan Ngo  
Fremont, CA

DIRECTOR  
Janet In  
Washington, DC

**ABA SECTION OF TAXATION  
COMMENTS CONCERNING PROPOSED TREASURY  
REGULATIONS UNDER SECTION 6708**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Megan L. Brackney, Larry A. Campagna, and John M. Colvin, of the Committee on Civil and Criminal Tax Penalties. These Comments were reviewed by Miriam Fisher of the Section’s Committee on Government Submissions, and by Scott D. Michel, Council Director for the Committee on Civil and Criminal Tax Penalties.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments, or have advised clients on the application of such rules, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contacts:	Larry Campagna <a href="mailto:larry.campagna@chamberlainlaw.com">larry.campagna@chamberlainlaw.com</a> (713) 654-9609	Megan L. Brackney <a href="mailto:mbrackney@kflaw.com">mbrackney@kflaw.com</a> (212) 808-8100
	John M. Colvin <a href="mailto:jcolvin@c-hlaw.com">jcolvin@c-hlaw.com</a> (206) 223-0800	Miriam Fisher <a href="mailto:miriam.fisher@lw.com">miriam.fisher@lw.com</a> (202) 862-5020
	Scott D. Michel <a href="mailto:SDM@Capdale.com">SDM@Capdale.com</a> (202) 637-2178	

Date: July 9, 2013

## EXECUTIVE SUMMARY

The following Comments are submitted in response to the request for comments made by the Department of Treasury (the “Treasury”) and the Internal Revenue Service (the “Service”) in Notice of Proposed Rulemaking dated March 8, 2013, regarding Prop. Reg. § 301.6708-1 (the “Proposed Regulation”)<sup>1</sup> issued under section 6708 of the Internal Revenue Code of 1986, as amended (the “Code”).<sup>2</sup> The Treasury and the Service requested taxpayer comments by June 6, 2013. A public hearing has been scheduled for July 2, 2013.

We appreciate that that the Treasury is issuing the Proposed Regulation to clarify the Service’s interpretation of section 6708. The Proposed Regulation provides material advisors and their representatives with much-needed guidance as to the computation of the penalty, extensions of time for compliance, and reasonable cause defenses. These Comments focus on four areas of concern: (i) the imposition of the penalty on the day of compliance when the response is untimely; (ii) extensions of time for complying with list maintenance requests; (iii) reasonable cause for failure to furnish lists within the twenty business-day time period; and (iv) the accumulation of penalties during the agent’s review.

First, we recommend that the penalty not be imposed for the day that the material advisor makes its submission. Next, with respect to both the Service’s discretion to extend the time period for response and the evaluation of reasonable cause, we believe that the Service should be afforded flexibility where the professional organization was not previously aware that a member of its organization was acting as a material advisor with respect to a reportable transaction. Finally, we believe that the Proposed Regulation should be revised to limit the accumulation of penalties during the agent’s review where after a specified period of time the material advisor has not been notified that its submission is deficient.

---

<sup>1</sup> 78 Fed. Reg. 14939 (2013).

<sup>2</sup> References to a “section” in the text of these Comments are to a section of the Code, unless otherwise indicated.

## **Comments on Proposed Regulation Section 301.6708-1**

Section 815 of the American Jobs Creation Act of 2004 (the “Act”)<sup>3</sup> amended sections 6111 and 6112 to replace the prior tax shelter registration regime with new rules that require material advisors to report and maintain lists with respect to reportable transactions. Sections 816 and 817 of the Act also amended sections 6707 and 6708 to create more severe penalties for failure to comply with the new material advisor rules.

### **I. Background of Sections 6708 and 6112**

Section 6112 requires that each material advisor with respect to a reportable transaction prepare and maintain a list and furnish such list upon written request of the Service.<sup>4</sup> The current regulations under section 6112 specify that the lists must, *inter alia*, identify each person to whom or for whose benefit the material advisor has made or provided a tax statement<sup>5</sup> and the taxpayers and advisors involved, and contain detailed descriptions of the tax structure and the purported tax treatment of the reportable transaction.<sup>6</sup> The material advisor must also maintain, and produce to the Service upon request, documents related to the transaction and any designation agreements.<sup>7</sup> The material advisor must retain the list and related documents for seven years following the earlier of the date on which the material advisor last made a tax statement relating to the transaction or the date the transaction was entered into, if known.<sup>8</sup>

---

<sup>3</sup> Pub. L. No. 108-357, 118 Stat. 1418.

<sup>4</sup> The terms “material advisor,” “reportable transaction,” and “tax statements” are defined in Reg. § 301.6111-3.

<sup>5</sup> Reg. § 301.6112-1(b)(2).

<sup>6</sup> Reg. § 301.6112-1(b)(3)(ii).

<sup>7</sup> Reg. § 301.6112-1(b)(3)(iii)(A)-(B).

<sup>8</sup> I.R.C. § 6112(b)(1)(B); Reg. § 301.6112-1(d).

The material advisor must furnish the list to the Service within twenty business days from the date of the Service's request.<sup>9</sup> A material advisor who fails to furnish the list upon request is subject to a penalty of \$10,000 for each calendar day after the twentieth business day that the material advisor fails to provide the list.<sup>10</sup> The Proposed Regulation states that the penalty accrues daily and continues for each calendar day until, and including, the day the person's failure to furnish a list in the required form ends.<sup>11</sup> There is no maximum penalty amount, and the penalty is cumulative.<sup>12</sup> The penalty generally applies to the entity acting as a material advisor (*e.g.*, a law firm or accounting firm), and not individual professionals working for the entity as employees or partners.<sup>13</sup> Section 6708(a)(2) provides an exception to the penalty for any failure that is due to reasonable cause.

## **II. Suggestions for Revisions to Prop. Reg. § 301.6708-1**

These Comments cover four areas of concern: (i) the imposition of the penalty on the day of compliance when the response is untimely; (ii) extensions of time for complying with list maintenance requests; (iii) reasonable cause for failure to furnish lists within the twenty business-day time period; and (iv) the accumulation of penalties during the agent's review where the material advisor fails to establish that it acted in good faith.

### **A. No Penalty Should Be Assessed on the Day of Compliance**

The Proposed Regulation describes how the Service will compute section 6708 penalties as follows:

---

<sup>9</sup> I.R.C. § 6708(a)(1); Reg. § 301.6112-1(e)(1).

<sup>10</sup> I.R.C. § 6708(a)(1).

<sup>11</sup> I.R.C. § 301.6708-1(e).

<sup>12</sup> I.R.C. § 6708(b).

<sup>13</sup> Reg. § 301.6111-3(b)(2)(iii)(A). The penalty, however, does apply to employees, partners or shareholders of the material advisor if the person forms or avails himself of the "material advisor" entity for the purpose of avoiding the rules of section 6111 or 6112, or the penalties of section 6707 or 6708.

The penalty imposed by section 6708 accrues daily, beginning on the first calendar day after the expiration of the 20-business-day period following a written list request, and continues for each calendar day thereafter until, and including, the day the person's failure to furnish a list in the form required by section 6112 and its corresponding regulation ends.<sup>14</sup>

Identical language is contained in Prop. Reg. § 301.6708-1(e)(2)<sup>15</sup> for computation of the penalty after a grant of an extension. Accordingly, if the Proposed Regulation is finalized in its current form, the Service will assess a penalty on the day that the material advisor becomes compliant.

Section 6708(a)(1) states that the penalty for failure to respond to the list maintenance request within twenty business days shall be imposed for “*each day of such failure after such 20<sup>th</sup> day.*” We interpret the statutory language “each day of such failure” to mean that the penalty only may be imposed for days in which the material advisor is not in compliance. On the day that the response is submitted to the Service, there is no failure to respond. Accordingly, we suggest that Prop. Reg. § 301.6708-1(e)(1) and (2) be revised to state that the penalty “accrues daily. . . and continues for each calendar day thereafter *until the last day before* the person's failure to furnish a list in the form required by section 6112 and its corresponding regulation ends.”

**B. Extensions Should Be Available Where the Firm Did Not Know That It Was a Material Advisor**

The Proposed Regulation defines the circumstances under which the Service may grant extensions of the twenty business-day deadline. In the Explanation of Provisions, Treasury explains that Congress intended for the section 6708 penalty to be “time-sensitive,” and accordingly the Service will not grant extensions where a significant reason for the request is to delay production of the list.

---

<sup>14</sup> Prop. Reg. § 301.6708-1(e)(1), 78 Fed. Reg. 14939 (2013).

<sup>15</sup> 78 Fed. Reg. 14939 (2013).

The Proposed Regulation permits the Service to grant extensions, at its discretion, if prior to the expiration of the twenty-business day period, the advisor cannot meet the deadline despite diligent efforts to maintain the materials and furnish the list.<sup>16</sup> The advisor must submit a written extension request that: (i) briefly describes the information and documents that comprise the list; (ii) explains why additional time is necessary; (iii) proposes a schedule for completion of the production of the list; (iv) states that to the best of the person's knowledge, all information and records relating to the list have been maintained in accordance with section 6001 and 6112; and (v) states that the request is not made for the purpose of avoiding the list maintenance obligations.<sup>17</sup>

We believe that the bases for extension should include a circumstance in which the entity receiving a request for a section 6112 list did not know that it was a material advisor with respect to one or more reportable transactions because one of the firm's professionals failed to disclose the transactions in contravention of established firm policy.

The Proposed Regulation contains an example where a brief extension may be granted. In the example in Proposed Regulation § 301.6708-1(c)(4),<sup>18</sup> a large law firm is a material advisor that has educated its attorneys about reportable transactions and the reporting and list maintenance rules and has policies in place to ensure compliance, but unbeknownst to the firm, one of its attorneys no longer with the firm did not comply with those policies with respect to one transaction. Because the firm will have to search for responsive documents in its storage facility and contact clients for information, it will not be able to respond to the list maintenance request within twenty business days. In this

---

<sup>16</sup> Prop. Reg. § 301.6708-1(c)(3), 78 Fed. Reg. 14939 (2013).

<sup>17</sup> Prop. Reg. § 301.6708-1(c)(3)(ii), 78 Fed. Reg. 14939 (2013).

<sup>18</sup> 78 Fed. Reg. 14939 (2013).

example, the Service would grant a ten-day extension with respect to the one transaction at issue.<sup>19</sup>

This example does not address a professional services firm, which, despite its best efforts, is not aware that one of its professionals has acted as a material advisor. In this situation the firm requires additional time to respond because, prior to the receipt of the request from the Service, it was not aware of the transactions and requires additional time to locate information. Since it is the firm, and not the individual attorney, that is liable for the penalty, the Service should consider granting an extension of time to the firm under these circumstances. We recommend that the examples include a situation in which the firm is not aware that an individual attorney has acted as a material advisor.

In addition, we suggest that the following language be added to Prop. Reg. § 301.6708-1(c)(3)(ii):

The person requesting an extension must briefly describe the information and documents that comprise the list as required by section 6112, explain the circumstances that would warrant additional time, propose a schedule for the completion of the production of the list, state that to the best of the person's knowledge all information and records relating to the list under the possession, custody, or control of the person have been maintained in accordance with procedures and policies that are consistent with sections 6001 and 6112 of the Internal Revenue Code (*or provide a detailed explanation of the procedures such person has in place to comply with the requirements of section 6112, its efforts to adhere to such procedures, and the reasons why the specific information and records sought in the request were not so maintained*), and state that the extension request is not being made for purposes of avoiding the person's list maintenance obligations imposed by section 6112 and its corresponding regulations.

**C. Reasonable Cause Should Include the Firm's Lack of Knowledge that It Was a Material Advisor**

Section 6708(a)(2) provides an exception to the penalty for any failure that is due to reasonable cause. The reasonable cause determination is made on a case-by-case and

---

<sup>19</sup> Prop. Reg. § 301.6708-1(c)(4), 78 Fed. Reg. 14939 (2013).

day-to-day basis, taking into account all relevant facts and circumstances. The grounds for reasonable cause include good faith, the exercise of ordinary business care, supervening events, and reliance on an independent opinion or advice.<sup>20</sup>

The Proposed Regulation states that the most important factor is the material advisor's good faith effort to comply with section 6112. The good faith factors include the material advisor's efforts to: (i) determine or assess status as a material advisor; (ii) determine the information and documentation required to be maintained; (iii) meet its obligations to maintain a readily-producible list; (iv) make the list available to the Service within the twenty-business day period (or extended period); and (v) ensure that the list furnished to the Service is accurate and complete.<sup>21</sup>

The exercise of ordinary business care also may constitute reasonable cause. Ordinary business care would include the material advisor establishing and adhering to procedures reasonably designed and implemented to ensure compliance with section 6112. Also, the material advisor must take immediate steps to correct any failure relating to the list upon discovery. A failure to take immediate remedial measures weighs against a finding that the material advisor exercised ordinary business care. The Proposed Regulation indicates that isolated and inadvertent failures to immediately make corrections will not prevent a finding of ordinary business care, but only if the material advisor had established and adhered to its compliance procedures.<sup>22</sup>

As discussed above in connection with requests for extension, the Service should be able to exercise discretion in favor of a firm that did not know that it was a material advisor with respect to one or more transactions because one of the firm's professionals

---

<sup>20</sup> Prop. Reg. § 301.6708-1(g), 78 Fed. Reg. 14939 (2013).

<sup>21</sup> Prop. Reg. § 301.6708-1(g)(2), 78 Fed. Reg. 14939 (2013).

<sup>22</sup> Prop. Reg. § 301.6708-1(g)(3), 78 Fed. Reg. 14939 (2013).

failed to disclose the transactions in contravention of established firm policy. We recommend that the Service expand the illustrations of reasonable cause to include such a situation.

**D. Penalties Should Be Suspended If the Service Does Not Respond to the Material Advisor Regarding Any Deficiencies in the List Within a Specified Period from the Date the List Is Provided by the Material Advisor**

The Proposed Regulation provides that the review period will *not* be treated as days out of compliance for purposes of the computation of the penalty when the material advisor establishes that it acted in good faith in efforts to comply with the provisions of section 6112, but the review period will be treated as a period of non-compliance when the material advisor fails to establish such good faith.

Review by IRS. Whether reasonable cause exists for a period of time will be determined based on all the relevant facts and circumstances, including facts and circumstances arising subsequent to the request for the list. If a material advisor establishes that it acted in good faith, as defined in paragraph (g)(2) of this section, in its efforts to comply with the provisions of section 6112 and its corresponding regulations, the material advisor will be deemed to have reasonable cause for the periods of time taken by the IRS to review a furnished list for compliance with the requirements of section 6112 and to inform the material advisor of any identified failures in the list. If the material advisor does not establish that it acted in good faith, the IRS will not consider the time taken by the IRS to review a list or inform a material advisor of identified failures as a factor in determining whether the material advisor has reasonable cause for that period.<sup>23</sup>

We suggest that once the Service has had a specified reasonable period of time to review the list provided by the material advisor, the penalty should stop accumulating until the material advisor has been notified of any deficiency in the list and is given notice and opportunity to remedy any deficiencies in compliance. The penalty should not begin to accrue again until the Service notifies the material advisor that the list appears deficient.

---

<sup>23</sup> Prop. Reg. § 301.6708-1(h)(2), 78 Fed. Reg. 14939 (2013).