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New and Improved Confidential Transaction Rules

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On December 30, 2003, the Treasury Department published revisions to the final regulations that describe the circumstances under which taxpayers are required to report "confidential transactions" to the IRS.

Background

On February 28, 2003, the IRS adopted final Regulations that require every taxpayer that has participated in a "reportable transaction" to attach to its tax return a Form 8886, "Reportable Transaction Disclosure Statement." A "reportable transaction" includes one that is "offered under conditions of confidentiality." Prior to the revisions, the original rules in the final Regulations were extremely broad and did not require that either the conditions or the confidentiality relate to tax matters. In addition to investments traditionally thought of as tax shelters, the old rules were considered to apply to customary commercial transactions such as private placements, syndicated loans, and mergers and acquisitions if the governing documents provided for the parties to maintain confidentiality as to the underlying transactions or investments. Under the original rules, the presumption of non-confidentiality could only be met if the transaction documents included language that expressly permitted the disclosure of the tax treatment or tax structure of the underlying transactions. Many tax advisors were slow to advise their clients to either report transactions or to include the permitted disclosure language within the governing documents, relying on the fact that many commentators viewed the old rules as overly broad.

The December 30 Revisions

Under the new rules, a transaction is offered under conditions of confidentiality only if: (i) the taxpayer pays an advisor (or a person related to an advisor) a "minimum fee" for the transaction equal to at least \$250,000 for a corporation or \$50,000 for all other taxpayers and (ii) the advisor limits the disclosure by the taxpayer of the tax treatment or tax structure of the transaction in order to protect the confidentiality of the advisor's tax strategies. The minimum fee includes any fee paid for non-tax as well as tax services for the transaction, including the negotiation, documentation and implementation of the transaction. A fee does *not* include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction.

This new definition will remove most of the transactions that were considered to be improper targets of the disclosure regulations and will relieve both taxpayers and their advisors from the burden of either including language that permitted disclosure, which often made the parties to the transaction uncomfortable, or filing Form

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8886 with the IRS and disclosing transactions that did not seem to be the proper subject of a "tax shelter" disclosure requirement.

Transactions that will have to be disclosed under the new rules include those that are part of a confidential tax strategy promoted by a tax advisor, an investment bank or other advisor who will be paid at least the minimum fee amount described above. The new rules may, to some extent, expand the disclosure category for these types of transactions because disclosure is required for transactions that are described as proprietary or exclusive, even if limitations on disclosure are not legally enforceable. However, the disclosure requirement can be avoided if the advisor confirms that there is no limitation on the taxpayer's ability to disclose the tax treatment or tax structure of the transaction.

The amendments to the final regulations are generally applicable to transactions entered into on or after December 29, 2003, but taxpayers are permitted to rely on the new rules for transactions entered into on or after January 1, 2003.

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