7/29/05

SUMMARY OF TAX SHELTER AND TAX HAVEN REFORM ACT of 2005 (S. 1565)

TITLE I – Strengthening Tax Shelter Penalties

- ***Strengthens the penalties for (see attached chart):***
  - promoting abusive tax shelters
  - knowingly aiding or abetting a taxpayer in understating tax liability

TITLE II – Preventing Abusive Tax Shelter Transactions

Prohibit tax service fees dependant upon specific tax savings

- Prohibits charging a fee for tax services in an amount that is calculated according to or dependant upon a projected or actual amount of tax savings or losses offsetting taxable income. Builds on contingent fee prohibitions in more than 20 states, AICPA rules applicable to accountants, SEC regulations applicable to auditors of publicly traded corporations, and proposed PCAOB rules for auditors. Based upon investigation by Permanent Subcommittee on Investigations showing tax practitioners are circumventing current constraints.

Deter Financial Institution Participation in Abusive Tax Shelter Activities

- Requires federal bank regulators and the SEC to develop examination techniques to detect violations by financial institutions of the prohibition against providing products or services that aid or abet tax evasion or that promote or implement abusive tax shelters. Regulators must use such techniques at least every 2 years in routine or special examinations of specific institutions and report potential violations to the IRS. The agencies must also prepare a joint report to Congress in 2007 and 2010 on preventing the participation of financial institutions in tax evasion or tax shelter activities.

Increase disclosure of certain tax shelter information

- Authorizes Treasury to share certain tax return information with the SEC, federal bank regulators, or PCAOB, under certain circumstances, to enhance tax shelter enforcement or combat financial accounting fraud. Clarifies Congressional subpoena authority to obtain information (but not a taxpayer return) from tax return preparers. Clarifies Congressional authority to obtain certain tax information (but not a taxpayer return) from Treasury related to an IRS decision to grant, deny, revoke, or restore an organization's tax exempt status.

Require Tougher Tax Shelter Opinion Standards for Tax Practitioners

- Codifies and expands Treasury's authority to beef up Circular 230 standards for tax practitioners providing "opinion letters" on specific tax shelter transactions.

Increase Incentives for IRS Whistleblowers

- Encourages persons to blow the whistle on tax misconduct by establishing a Whistleblower Office within the IRS to provide consistent, equitable treatment of persons bringing information to the IRS. Codifies standards for awarding a portion of proceeds collected from actions based on information they bring to the IRS's attention. Modeled on provision passed by the Senate in the Highway Bill. Estimated to raise $407 million over 10 years.

Deny tax deduction for fines, penalties and settlements.

- Clarifies that penalties, fines and settlements paid to the government are not deductible. Passed by the Senate in the Highway Bill. Estimated to raise $200 million over 10 years.

"Sense of the Senate" on IRS Enforcement Priorities

- Establishes the Sense of the Senate that additional funds should be appropriated for IRS enforcement, and that the IRS should devote proportionately more of its enforcement funds to combat: (1) the promotion of abusive tax shelters for corporations and high net worth individuals and the aiding or abetting of tax evasion, (2) the involvement of accounting, law and financial firms in such promotion and aiding or abetting, and (3) the use of offshore financial accounts to conceal taxable income.

TITLE III – Requiring Economic Substance

Strengthen the Economic Substance Doctrine

- Strengthens and codifies the economic substance doctrine to invalidate transactions that have no economic substance or business purpose apart from tax avoidance or evasion. Also increases penalties for understatements attributable to a transaction lacking in economic substance. Passed by the Senate in the Highway Bill. Estimated to raise $15.9 billion over 10 years.

TITLE IV – Deterring Offshore Tax Evasion

Deter Use of Uncooperative Tax Havens

- Deters taxpayer use of uncooperative tax havens with corporate, bank or tax secrecy laws, procedures, or practices that impede U.S. enforcement of its tax laws by: (1) requiring disclosure on taxpayer returns of any payment above $10,000 to accounts or persons located in such tax havens, and (2) ending the tax benefits of deferral and foreign tax credits for any income earned in such tax havens. Gives Treasury Secretary discretion to designate a tax haven as uncooperative and publish an annual list of those jurisdictions. Estimated to raise $87 million over 10 years.

Strengthen Penalties for Concealing Income in Offshore Accounts

- Toughens penalties on taxpayers who, despite being eligible, did not participate in Treasury programs to encourage voluntary disclosure of previously unreported income placed by the taxpayer in offshore accounts and accessed through credit card or other financial arrangements. Passed by the Senate in the Highway Bill. Estimated to raise $10 million over 10 years.

Stop Schemes to get Foreign Tax Credit Without Reporting Related Income

- Authorizes Treasury to promulgate regulations to address abusive foreign tax credit (FTC) schemes that involve the inappropriate separation or stripping of foreign taxes from the related foreign income so taxpayers get the benefit of the FTC but don't report the related income. The provision becomes effective for transactions entered into after the date of enactment. Passed by the Senate in the Highway Bill. Estimated to raise $16 million over 10 years.

Tax Shelter Promoter and Material Advisor Penalties

Violation	Current Law (after FSC/ETI Bill)	Provisions in Levin/Coleman Tax Shelter and Tax Haven Reform Act
Promotion of abusive tax shelters. IRC § 6700	50% of the promoters' gross income from the activity.	Not to exceed the greater of: i) 150% of the promoters' gross income from the prohibited activity, or ii) amount assessed against the taxpayer for using abusive shelter (including backtaxes, penalties and interest). (§101)
Knowingly aiding and abetting understatement of tax liability. IRC § 6701	Maximum of $1,000 ($10,000 for a corporation). ***Penalty applies only to tax return preparer.***	Not to exceed the greater of: i) 150% of the aider/abettor's gross income from the prohibited activity, or ii) amount assessed against the taxpayer for the understatement (including backtaxes, penalties and interest). ***Penalty applies to all aiders/abettors, not just preparers.*** (§102)