New York State Department of Taxation and Finance
Office of Tax Policy Analysis
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Disclosure of Certain Transactions and Related Information Regarding Tax Shelters

The Tax Law has been amended to provide new reporting requirements with respect to the disclosure of information relating to transactions that present the potential for tax avoidance (a tax shelter). These new reporting requirements are similar to the tax shelter disclosure requirements for federal income tax purposes. Separate reporting requirements are imposed on those who utilize tax shelters and those who promote the use of tax shelters. The amendments also impose penalties for nondisclosure and the underpayment of taxes due to participation in these transactions, extend the statute of limitations for assessments relating to these transactions, and create a voluntary compliance initiative to allow taxpayers to report and pay underreported tax liabilities and interest attributable to these transactions with a waiver of penalties.

Reporting requirements for taxpayers and persons required to file returns or reports under Articles 9, 9-A, 22, 32, or 33

Who must file a disclosure and what must be disclosed

Every taxpayer or person who files a return or report under Articles 9, 9-A, 22, 32, or 33 of the Tax Law on or after June 13, 2005, who is **or was** also required to file a disclosure statement related to a reportable transaction or a listed transaction with the Internal Revenue Service (IRS), pursuant to section 6011 of the Internal Revenue Code (IRC), must disclose that information with the New York State return or report as described below (see **How to report** on page 2). Generally, the date filed is the date postmarked by the U.S. Postal Service. For more information about postmarks, see Publication 55, *Designated Private Delivery Services*. Disclosure is required if the taxpayer or person participated in tax shelter activities prior to July 1, 2007, for which a disclosure statement related to a reportable transaction or a listed transaction was required to be filed with the IRS. The term *return or report* includes original returns or reports, amended returns or reports, and applications for credit or refund of tax.

Each taxpayer or person must make its own disclosure, even though one member of an affiliated group, as defined by section 1504 of the IRC, may file the disclosure statement with the IRS on behalf of its affiliates including the taxpayer or person. For purposes of Article 22, a group agent who is authorized to file a group return on behalf of a group of nonresident members must make this disclosure with the group return; the individual group members are not required to make this disclosure.

A taxpayer or person who files a return or report under Articles 9, 9-A, 22, 32, or 33 of the Tax Law includes:

- corporations subject to tax under sections 183, 184, 185 or 186 and persons subject to tax under sections 186-a or 186-e of the Tax Law (Article 9);
- general business corporations (Article-9-A);

- individuals including sole proprietors, partnerships (including a limited liability company (LLC) that is treated as a partnership for federal income tax purposes), estates and trusts, partners in a partnership (including members of a LLC that is treated as a partnership for federal income tax purposes), shareholders of an S corporation, and beneficiaries of an estate or trust (Article 22);
- banking corporations (Article 32); and
- insurance corporations and captive insurance companies (Article 33).

How to report

A new form, Form DTF-686, *Tax Shelter Reportable Transactions- Attachment to New York State Return*, has been developed to assist taxpayers and persons in complying with New York State's disclosure requirements. Attach a duplicate of the IRS disclosure statement and any related information submitted to the IRS to Form DTF-686 and attach Form DTF-686 to the return or report filed by the taxpayer or person for the current tax year. Currently, the IRS uses IRS Form 8886 and Schedule M-3 as its disclosure statement. Any disclosure information attached to Form DTF-686 must include the taxpayer or person's name(s) and taxpayer identification number(s) shown on Form DTF-686.

In addition, the taxpayer or person must also disclose with its **first** return or report filed on or after June 13, 2005:

- all disclosure statements that were required to be filed with the IRS at any time with respect to listed transactions for which the taxpayer or person filed a New York State return or report for the tax year in which the transaction occurred under Articles 9, 9-A, 22, 32, or 33 of the Tax Law, and
- all disclosure statements that were required to be filed with the IRS with respect to reportable transactions, other than listed transactions, in which the taxpayer participated during any tax year for which the statute of limitations for assessment has not expired as of April 12, 2005. For this purpose, the statute of limitations for assessment under sections 683 and 1083 of the Tax Law in effect prior to April 12, 2005, is used and the new extended statutes of limitations for tax avoidance transactions, described below, do not apply.

However, disclosure is not required for tax shelter activities in which the taxpayer or person participated on or after July 1, 2007.

Examples

Example 1: Corporation XYZ, a corporation subject to tax under Article 9-A of the Tax Law (the business corporation franchise tax) since 1996, has a fiscal year ending March 31, 2005. Its franchise tax return is filed June 15, 2005. It must include with that first return Form DTF-686 and attach thereto a copy of:

1. the IRS disclosure statements for all listed transactions required to be reported to the IRS since 1996, even those transactions for which the statute of limitations for assessment has expired,
2. the IRS disclosure statements for all reportable transactions, other than listed transactions, in which the corporation participated during any tax year for which the statute of limitations for assessment has not expired as of April 12, 2005, and
3. the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information submitted to the IRS for the current tax year.

For tax years ending March 31, 2006, and March 31, 2007, the corporation must attach to Form DTF-686 only a copy of the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information that was filed with the IRS for that particular tax year. When the corporation's tax return is filed for that particular tax year, whenever filed, Form DTF-686 and any attachment is attached to that return.

For tax year ending March 31, 2008, the corporation must attach to Form DTF-686 only a copy of the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information that was filed with the IRS for that tax year. When the corporation's tax return is filed for that particular tax year, whenever filed, Form DTF-686 and any attachment is attached to that return. However, only tax shelter activities that occurred prior to July 1, 2007, must be disclosed.

Example 2: Corporation ABC, a foreign corporation, first becomes subject to tax under Article 9-A of the Tax Law in 2006. The corporation is a calendar year filer. Its return for calendar year 2006 is due March 15, 2007. The corporation is granted an extension of time to file its return until September 15, 2007. When the return is filed, the corporation must attach to Form DTF-686 only a copy of the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information that was filed with the IRS for that tax year, and Form DTF-686 is attached to its tax return. No disclosure of listed and reportable transactions that were reported to the IRS for tax years prior to 2006 is required because the corporation was not subject to tax in New York State for those tax years.

For calendar year 2007, the corporation is granted an extension of time to file its return until September 15, 2008. When the return is filed, the corporation must attach to Form DTF-686 only a copy of the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information that was filed with the IRS for that tax year, and Form DTF-686 is attached to that return. However, only tax shelter activities that occurred prior to July 1, 2007, must be disclosed.

Example 3: Mr. Smith, a taxpayer subject to tax under Article 22 of the Tax Law (the personal income tax) since 1998, files his 2004 tax return on April 15, 2005, and his 2005 tax return on April 13, 2006. No disclosure of listed and reportable transactions that were reported to the IRS is required with his 2004 tax return. However, he must include with his 2005 tax return, Form DTF-686 and attach a copy of:

1. the IRS disclosure statements for all listed transactions required to be reported to the IRS since 1998, even those transactions for which the statute of limitations for assessment has expired,
2. the IRS disclosure statements for all reportable transactions, other than listed transactions, in which he participated during any tax year for which the statute of limitations for assessment has not expired as of April 12, 2005, and
3. the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information submitted to the IRS for the current tax year.

Example 4: Assume the same facts as described in *Example 3*, except Mr. Smith files an amended 2004 tax return on June 27, 2005. He must include with that amended return, Form DTF-686 and attach a copy of:

1. the IRS disclosure statements for all listed transactions required to be reported to the IRS since 1998, even those transactions for which the statute of limitations for assessment has expired,
2. the IRS disclosure statements for all reportable transactions, other than listed transactions, in which he participated during any tax year for which the statute of limitations for assessment has not expired as of April 12, 2005, and
3. the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information submitted to the IRS for the current tax year.

However, since he disclosed all transactions described in items 1 and 2 above with his amended 2004 tax return, which is the first return filed on or after June 13, 2005, when he files his 2005 tax return on April 13, 2006, he must attach to Form DTF-686 only a copy of the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information that was filed with the IRS for his 2005 tax year, and Form DTF-686 is attached to his 2005 tax return.

Example 5: Assume the same facts as described in *Example 4*, except the amended 2004 tax return was filed pursuant to the voluntary compliance initiative described on page 8. He must include with that amended return, Form DTF-686 and attach a copy of:

1. the IRS disclosure statements for all listed transactions required to be reported to the IRS since 1998, even those transactions for which the statute of limitations for assessment has expired,
2. the IRS disclosure statements for all reportable transactions, other than listed transactions, in which he participated during any tax year for which the statute of limitations for assessment has not expired as of April 12, 2005, and
3. the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information submitted to the IRS for the current tax year.

However, since he disclosed all transactions described in items 1 and 2 above with his amended 2004 tax return, which is the first return filed on or after June 13, 2005, when he files his 2005 tax return on April 13, 2006, he must attach to Form DTF-686 only a copy of the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information that was filed with the IRS for his 2005 tax year, and Form DTF-686 is attached to his 2005 tax return.

Example 6: Ms. Jones is a taxpayer subject to tax under Article 22 of the Tax Law (the personal income tax) since 2001. Ms. Jones is granted an extension of time to file her 2004 tax return until August 15, 2005. She files her 2004 tax return on August 15, 2005. She must include with that return, Form DTF-686 and attach a copy of:

1. the IRS disclosure statements for all listed transactions required to be reported to the IRS since 2001, even those transactions for which the statute of limitations for assessment has expired,
2. the IRS disclosure statements for all reportable transactions, other than listed transactions, in which she participated during any tax year for which the statute of limitations for assessment has not expired as of April 12, 2005, and
3. the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information submitted to the IRS for the current tax year.

Example 7: Assume the same facts as described in *Example 6*, except Ms. Jones is not granted an extension of time to file her 2004 tax return. She files her 2004 tax return on June 15, 2005. She must include with that return, Form DTF-686 and attach a copy of:

1. the IRS disclosure statements for all listed transactions required to be reported to the IRS since 2001, even those transactions for which the statute of limitations for assessment has expired,
2. the IRS disclosure statements for all reportable transactions, other than listed transactions, in which she participated during any tax year for which the statute of limitations for assessment has not expired as of April 12, 2005, and
3. the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information submitted to the IRS for the current tax year.

Example 8: Assume the same facts as described in *Example 6* and Ms. Jones files an amended 2004 tax return on August 29, 2005. She must include with that return, Form DTF-686 and attach only a copy of the IRS disclosure statement (currently IRS Form 8886 and Schedule M-3) and any related information submitted to the IRS for the 2004 tax year.

(Tax Law, section 25(a)(1); Ch. 61 of the Laws of 2005, Part N, section 12)

New York reportable transactions

The Tax Law has also been amended to allow the Commissioner of Taxation and Finance to prescribe by regulation New York reportable transactions. A *New York reportable transaction* is a transaction that has the potential to be a tax avoidance transaction with regard to returns or reports required under Articles 9, 9-A, 22, 32, or 33 of the Tax Law. Once regulations are prescribed, the Commissioner may designate specific transactions as New York tax avoidance transactions by public notice or some other form of published guidance.

(Tax Law, section 25(a)(2), (3), and (4))

Reporting requirements for material advisors

Who must report and what must be reported

Every person required to make and file a statement or return pursuant to section 6111 of the IRC (a material advisor) on or after April 12, 2005, and prior to July 1, 2007, must file a duplicate of that statement or return (currently IRS Form 8264), including all documentation submitted to the IRS in connection with the statement or return, with the Commissioner of Taxation and Finance if **any** of the following conditions apply:

(A) the person is organized in this state,
(B) the person is doing business in this state,
(C) the person is deriving income in this state, or
(D)(i) the list, required to be maintained by this person pursuant to section 6112 of the IRC, identifies or is required to identify a taxpayer subject to tax under Articles 9, 9-A, 22, 32, or 33 of the Tax Law, and
(ii) this person is a material advisor, as defined in section 6111 of the IRC, who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction.

How to report

A new form, Form DTF-664, *Tax Shelter Disclosure for Material Advisors,* has been developed to assist material advisors in complying with New York State's disclosure requirements. The duplicate statement or return as described above (see **Who must report and what must be reported**) must be filed with the Commissioner of Taxation and Finance by the later of:

- 60 days from the date required for filing the statement or return with the IRS,
- 60 days from the date that any of the conditions ((A), (B), (C), or (D)) described above first applies, or
- September 9, 2005.

Attach a copy of IRS Form 8264, *Application for Registration of a Tax Shelter,* to Form DTF-664, *Tax Shelter Disclosure for Material Advisors*, and mail to:

NYS Department of Taxation and Finance
Tax Shelter Disclosure
PO Box 22104
Albany NY 12201

(Tax Law, section 25(b)(1))

Additional reporting requirements for material advisors

Every person who is required to maintain a list of persons pursuant to section 6112 of the IRC (a material advisor), must maintain a duplicate of this list if any of the conditions ((A), (B), (C), or (D)) described above applies to this person. The material advisor must furnish a copy of the list to the Commissioner of Taxation and Finance within 20 days after written request is made for the list.

(Tax Law, section 25(c))

Additional tax shelter recordkeeping requirements

Every person required by section 25 of the Tax Law to disclose any transaction, file any duplicate report, or maintain any list, must retain all relevant correspondence, memoranda, notes, valuation studies, meeting minutes, spreadsheets, models, opinions, records required to be retained pursuant to section 6011 of the IRC, and all other records or documents related to the disclosure, filing and list maintenance requirements of section 25 of the Tax Law for six years. The information must be made available for inspection in connection with any examination.

(Tax Law, section 25(d))

Extended statutes of limitations

If a taxpayer or person fails to file, disclose or provide any statement, return or other information for any tax year with respect to a listed transaction, the time for assessment of any tax imposed under Articles 9, 9-A, 22, 32, or 33 of the Tax Law with respect to the listed transaction does not expire before the date that is one year after the earlier of the:

- date the required statement, return, or information is furnished, or
- date that the material advisor provides a copy of the list maintained pursuant to section 6112 of the IRC that pertains to the listed transaction.

Tax may be assessed at any time within 6 years after the return was filed if the deficiency is attributable to an abusive tax avoidance transaction. An *abusive tax avoidance transaction* means a plan or arrangement devised for the principal purpose of avoiding tax. Abusive tax avoidance transactions include, but are not limited to, listed transactions. A listed transaction includes any transaction designated as a tax avoidance transaction by the IRS or the Commissioner of Taxation and Finance.

(Tax Law, sections 683(c)(11) and 1083(c)(11))

Penalties

The Tax Law was also amended to provide new stiffer penalties for:

- taxpayers' substantial understatement of tax where the understatement is attributable to a tax shelter transaction;
- taxpayers' understatement of tax where the understatement is attributable to a reportable transaction;
- paid preparers that aid or assist in the giving of fraudulent returns, reports, statements, or other documents under Article 22 of the Tax Law;
- taxpayers or persons who fail to disclose or provide reportable transaction information;
- material advisors who fail to disclose or provide the reportable transaction statement or return;
- material advisors who fail to provide a duplicate of the list maintained pursuant to 6112 of the IRC;
- tax return preparers who fail to disclose the tax position taken on a return or claim for refund that results in an understatement of tax liability, or if disclosed, the position taken had no reasonable basis, or who willfully attempts to understate the tax liability or recklessly or intentionally disregard the rules and regulations; and
- promoters of abusive tax shelters.

(Tax Law, sections 685(p), 685(p-1), 685(r), 685(x), 685(y), 685(z), 685(aa), 685(bb), 1085(k), 1085(k-1), 1085(p), 1085(q), 1085(r), 1085(s), and 1085(t))

Voluntary Compliance Initiative

The Tax Law was also amended to establish a voluntary compliance initiative (VCI) to be administered by the Commissioner of the Department of Taxation and Finance. The VCI allows taxpayers to report and pay underreported tax liabilities and interest attributable to abusive tax avoidance transactions. This voluntary compliance program applies to tax liabilities under Articles 9, 9-A, 22, 30, 32, or 33 of the Tax Law attributable to the use of tax avoidance transactions for tax years beginning before January 1, 2005. Taxpayers participating in this initiative will have the option to participate with a waiver of the right to appeal their liability for any taxes paid under the program, or to participate with the right to appeal. If a taxpayer forgoes the right to appeal, all applicable penalties are waived. Participation with appeal rights results in a waiver of all penalties except the negligence and substantial understatement penalties under the Tax Law in effect on December 31, 2004. The VCI begins October 1, 2005, and ends March 1, 2006. Further details of the VCI will be announced in a forthcoming publication.

(Ch. 61 of the Laws of 2005, Part N, section 11)