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New York Proposes Regulations Defining “Reportable Transactions”

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The New York State Department of Taxation and Finance (“Department”) has issued proposed regulations regarding New York reportable transactions. The proposed regulations were published in the New York State Register on October 25, 2006 and are subject to a 45-day comment period.

Tax practitioners and taxpayers have eagerly awaited regulations regarding “New York reportable transactions” since the passage of tax shelter legislation in April of 2005. The 2005 tax shelter legislation failed to identify specific transactions considered New York listed transactions. As a result, taxpayers and practitioners were left to speculate and wait for further guidance. While the additional guidance in the proposed regulations is welcomed, it will not likely satisfy those individuals expecting the Department to identify and detail specific transactions or situations as New York listed transactions. The highlights of the proposed regulations are described below.

Background

In April of 2005, New York Tax Law Section 25 was passed mandating that every person required to disclose reportable transactions or listed transactions under the Internal Revenue Code attach a copy of the federal disclosure statement to their New York State tax return. Failure to comply with the law subjects a taxpayer to a range of harsh penalties. In addition, the law requires taxpayers to disclose participation in any New York reportable transaction (“Reportable Transaction”). The law defines a Reportable Transaction as a transaction that “has the potential to be a tax avoidance transaction as determined by the commissioner” or a transaction that is the same or substantially similar to such a transaction. The purpose of the proposed regulations is to provide a definition of a Reportable Transaction and to provide guidance regarding the disclosure requirements for those participating in a Reportable Transaction.

Definition of a New York Reportable Transaction

Under the proposed regulation, there are three categories of Reportable Transactions: New York listed transactions, New York confidential transactions and New York transactions with contractual protection.

i. New York Listed Transactions

A New York listed transaction is a transaction that is the same as, or substantially similar to, one of the potential tax avoidance transactions that the Commissioner of the Department (“Commissioner”) has identified as a New York listed transaction by notice or other published guidance. To characterize a particular transaction as a New York listed transaction, the Commissioner must find that (1) the transaction is not done for a valid business purpose constituting the primary motivation for the transaction, other than obtaining “tax benefits,”¹ (2) the transaction lacks economic substance apart from providing tax benefits, or (3) the tax treatment of the transaction elevates form over substance. A taxpayer will be considered a participant in a New York listed transaction if its tax return reflects tax consequences or strategies that are described by notice or other published guidance as a New York listed transaction.

The fact that the proposed regulations do not define the terms “business purpose” or “economic substance” arguably provides flexibility for the Commissioner, and uncertainty for taxpayers and their advisors. The proposed regulations do not identify any specific New York listed transaction. Taxpayers and practitioners are left with uncertainty and speculation.

ii. New York Confidential Transactions

A New York confidential transaction is defined as a transaction proposed by an advisor under the condition of confidentiality and for which the taxpayer pays an “advisor fee.” Under the proposed regulation, a condition of confidentiality occurs if the advisor places limits on disclosure of the tax treatment or structure of the transaction. Further, the limits on disclosure must be such that they protect the confidentiality of the advisor’s tax strategies. It should be noted that even if the taxpayer is not legally bound by the conditions of confidentiality, a transaction will be treated as confidential.

An “advisor fee” for this purpose is any fee for a tax strategy, advice, or implementation of a transaction. This includes fees paid for services to analyze, implement and document a transaction, as well as preparation of tax returns to the extent that the fees exceed the fees customary for return preparation.

iii. New York Transactions with Contractual Protection

A New York transaction with contractual protection occurs when the taxpayer has a right to a refund of fees if the intended tax consequences of the transaction are not achieved and also includes contingent fee arrangements. However, a transaction will not be considered contractually protected if a person advises a taxpayer about the potential consequences of a transaction after the taxpayer entered into the transaction and

¹ As defined by the proposed regulations, a “tax benefit” includes deductions, exclusions, and modifications included in gross receipts, gross earnings, income, gain, loss, assets, liabilities, total capital, capital stock, tax credits, non-recognition of gain, status as an entity exempt from New York State taxation, and any other tax consequences that reduce a taxpayer’s New York State tax liability by affecting the amount, timing, character, or source of any such item, amount or activity.

reported the transaction on a tax return, as long as the advisor had not previously received fees in connection with the transaction.

Other Important Provisions

i. Determinations and Protective Disclosures

Taxpayers who are uncertain as to whether disclosure is required with respect to a particular transaction may obtain the answer from the Department. On or before the date that disclosure would otherwise be required for a Reportable Transaction, a taxpayer may submit a request to the Department for a determination whether a transaction is subject to the disclosure requirements. The potential obligation of the taxpayer to disclose the transaction will be suspended during the period that the request is pending. If the Department determines that the transaction is a Reportable Transaction, the taxpayer will have sixty days from the date of the determination to submit a disclosure.

Alternatively, if a taxpayer is uncertain about whether a transaction is a Reportable Transaction, a taxpayer may disclose the transaction and indicate that the disclosure is being filed on a protective basis.

ii. Separate Disclosure Required for Each Member

The proposed regulations define “taxpayer” to include each member of a combined group filing under the corporate franchise tax, the banking tax or the insurance tax provisions. Therefore, each member of a combined group must disclose its participation in a Reportable Transaction separately.

iii. “Tax Returns” Are Broadly Defined

Under the proposed regulations, the term “tax return” includes original returns, amended returns and applications for tax credits or refunds. In addition, if a taxpayer files a return reflecting a tax strategy or consequence that the Commissioner later deems to be a New York listed transaction and the applicable statute of limitations has not expired for that return, the taxpayer is required to disclose that transaction on the taxpayer’s subsequent return. Taxpayers are required to retain all documents related to Reportable Transaction for six years.

iv. Effective Date

The proposed regulations will apply to taxable years beginning on or after January 1, 2006.■



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