

# Settlement Initiative for Section 302/318 Basis-Shifting Transactions

## Announcement 2002-97

The Internal Revenue Service announces an initiative to resolve cases involving basis-shifting transactions that are the same as or substantially similar to those described in Notice 2001-45, 2001-2 C.B. 129. Under the terms of this announcement, taxpayers who have engaged in basis-shifting transactions will be given the opportunity to resolve this issue on the terms set forth below with minimal further examination or other administrative proceedings. If taxpayers elect to resolve their cases in accordance with this announcement, they must notify the Service on or before December 3, 2002, as set forth below. Appeals is expected to issue settlement guidelines on the tax effect of basis-shifting transactions soon that will be the same as, or less favorable than, the terms set forth below.

### ELIGIBILITY REQUIREMENTS

Taxpayers are eligible to participate in this settlement initiative if:

- 1) The underpayment of tax attributable to the basis-shifting transaction is not due to fraud;
- 2) The basis-shifting transaction is not in litigation, *i.e.*, the issue is not docketed in and under the jurisdiction of any court, for any year, on the date the taxpayer elects to participate;
- 3) The basis-shifting transaction has not been designated for litigation, and, if not designated for litigation, the taxpayer has not been notified that the basis-shifting transaction issue is under consideration for designation for litigation;
- 4) Within 60 days from the mailing date of written notification from the Service of the decision not to designate, or to remove the designation of, the basis-shifting transaction issue, the taxpayer notifies the Service that it wishes to participate in this settlement initiative;
- 5) Upon request, the taxpayer provides to the Service the transactional documents to support the basis-shifting transaction, and the transaction conforms to the taxpayer's documents; and

6) The statute of limitations has not expired for any year in which the taxpayer claimed tax benefits relating to the basis-shifting transaction.

### TERMS OF THE RESOLUTION

This settlement initiative focuses on three aspects of a basis-shifting transaction: (i) the purchase and sale of shares in a corporation and options on shares in that corporation (hereinafter the "foreign bank"); (ii) the loss attributable to the amount of the claimed basis shift; and (iii) associated transaction costs. For purposes of this settlement initiative, the transaction costs will be deemed to be 8% of the sum of the amount of the basis shift and the cost of an option or warrant in a tax indifferent entity (hereinafter the "foreign corporation"), that was a party to the basis-shifting transaction.

1. The gain or loss on the taxpayer's purchase and sale of shares in a foreign bank and options on shares in the foreign bank will be reported in accordance with the terms of the purchase and sale transactions, but without regard to the claimed basis shift and excluding all transaction costs. Thus, if the taxpayer paid 100x dollars for 100x shares of the foreign bank on day one of the transaction, and sold 95x shares on day 100 of the transaction for 97x dollars, the taxpayer would report a gain of 2x dollars as either long or short term gain, either ordinary or capital, as would be otherwise appropriate.

2. The taxpayer will concede 80% of the claimed basis shift.

3. The taxpayer will concede the deduction of all transaction costs (other than deemed transaction costs, as described above) relating to the basis-shifting transaction. The taxpayer will concede 80% of the deemed transaction costs and treat 20% of the deemed transaction costs as a capital loss. The cost of the option or the warrant in the foreign corporation shall not be given any other effect.

### APPLICATION OF PENALTIES

The application of accuracy-related penalties to this transaction will be considered in each case. The following terms will be applied under this settlement initiative:

1. Transactions that were disclosed pursuant to the Disclosure Initiative, set forth

in Announcement 2002-2, 2002-2 I.R.B. 304, will not be subject to accuracy-related penalties.

2. Transactions that were not disclosed pursuant to the Disclosure Initiative may be subject to penalties based on the merits of the case, including whether the transaction was otherwise voluntarily disclosed.

3. Participation in this settlement initiative does not preclude taxpayers from contesting the application of penalties through normal audit and deficiency procedures.

### PROCEDURE FOR RESOLVING CASES

A decision by a taxpayer to resolve a case under the terms of this announcement must be mailed or delivered to the appropriate Service function, as set out below, on or before December 3, 2002.

If a taxpayer is under examination for the year(s) in which benefits from the basis-shifting transaction were claimed, the taxpayer must notify the examining agent in writing that the taxpayer wishes to participate in the settlement initiative. The examining agent will make the appropriate adjustments and prepare any necessary closing documents.

If a taxpayer is not under examination for any year in which benefits from the basis-shifting transaction were claimed, the taxpayer must notify the Office of Tax Shelter Analysis that it wishes to participate in the settlement initiative by sending a letter to the Office of Tax Shelter Analysis with the following information:

1. The taxpayer's name and address;
2. The taxpayer's Taxpayer Identification Number (either Social Security Number or Employer Identification Number);
3. The type of return filed;
4. The taxable periods for which the benefits of the basis-shifting transaction were claimed;
5. The amount attributable to the claimed basis-shifting transaction;
6. The cost of the option or warrant in the foreign corporation; and
7. A statement that the taxpayer is electing to resolve the case under the terms of this announcement.

The address of the Office of Tax Shelter Analysis is LM:PFTG:OTSA, 1111 Constitution Ave., N.W., Washington, D.C. 20224 and the fax number is (202) 283-8406.

Taxpayers must provide to the Service within ten (10) days of their request the information required by Announcement 2002-2 and certify under penalties of perjury that the person signing the disclosure has examined the disclosure and that to the best of that person's knowledge and belief, the information provided contains all relevant facts and is true, correct and complete.

If applicable, a settlement entered into as a result of this settlement initiative will be reported to the Joint Committee on Taxation in accordance with section 6405.

Denial of a taxpayer's request to participate in this shelter initiative is not subject to judicial review.

## PAPERWORK REDUCTION ACT

The collection of information contained in this announcement has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545-1803. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB number.

The collection of information in this announcement is in the sections titled APPLICATION OF PENALTIES and PROCEDURE FOR RESOLVING CASES. This information is required to apply the terms of the settlement set forth in this announcement and determine the appropriate amount of penalties due, if any. The information will be used to determine whether the taxpayer has reported the disclosed item properly for income tax purposes. The collection of information is required to obtain the benefit described in this announcement. The likely respondents are businesses or other for-profit institutions, small businesses or organizations, and individuals.

The estimated total annual reporting burden is 2000 hours.

The estimated annual burden per respondent varies from 3 hours to 7 hours, depending on individual circumstances, with

an estimated average of 5 hours. The estimated number of respondents is 400.

The estimated frequency of responses is one time per respondent.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

## CONTACT INFORMATION

For information regarding this announcement, call Carol Poindexter, Senior Program Analyst at (630) 493-5937 (not a toll-free call). Ms. Poindexter may also be reached by fax at (630) 493-5910. Alternatively, taxpayers may transmit comments electronically via the following e-mail address: [Carol.Poindexter@IRS.gov](mailto:Carol.Poindexter@IRS.gov). Please include "Announcement 2002-97" in the subject line of any electronic communication.