Wisconsin Department of Revenue

Special Bulletin

Tax Shelters Program

To: Taxpayers who have used tax shelters
Taxpayers required to disclose a "reportable transaction" to the IRS
Tax preparers for the above taxpayers

As part of an ongoing effort between many states, the Internal Revenue Service (IRS), and the Multistate Tax Commission (MTC), Wisconsin has passed new laws to discourage participation in abusive tax shelters and to require that certain types of transactions be specifically disclosed to the Wisconsin Department of Revenue.

Generally, the new laws require that whenever a taxpayer or taxpayer's advisor is required to file a statement with the IRS about a transaction the IRS has categorized as a "reportable transaction" (a transaction which could potentially be an abusive tax shelter), the taxpayer or material advisor must file a copy of that statement with the Wisconsin Department of Revenue. This requirement is retroactive to taxable years beginning on or after January 1, 2001.

With these requirements, the new law also provides for a voluntary compliance program for taxpayers that failed to report their full taxable income because they used abusive tax shelter transactions. The law outlines new, stringent penalties for taxpayers and advisors who do not comply with the tax shelter laws. The Tax Shelters Voluntary Compliance Program is a way of allowing time for taxpayers to comply with the new requirements and pay any taxes previously avoided with tax shelters before these penalties take effect.

The Tax Shelters Voluntary Compliance Program ends **May 31, 2008**. The due date for taxpayers to disclose to Wisconsin their reportable transactions occurring in pre-2007 years is also **May 31, 2008**.

The purpose of this bulletin is to provide information about:

- The Tax Shelters Voluntary Compliance Program
- The new disclosure requirements for taxpayers
- The new disclosure requirements for material advisors
- How to obtain more information if you have additional questions

About the Tax Shelters Voluntary Compliance Program...

What is an "abusive tax shelter?"
An abusive tax shelter (also known as a "tax avoidance transaction") is any transaction, plan or arrangement devised for the principal purpose of avoiding federal or Wisconsin taxes. An abusive tax shelter includes, but is not limited to:

- A "listed transaction." A listed transaction is a transaction that is the same as or substantially similar to one the IRS has determined to be an abusive tax shelter by published guidance. The IRS maintains a list of these transactions on its web site at www.irs.gov/businesses/corporations, in the section for "Abusive Tax Shelters."

- A transaction devised for the principal purpose of avoiding Wisconsin income or franchise taxes without providing a similar benefit for federal income tax purposes.

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How do I know if I'm involved in an abusive tax shelter?
Following is a list of questions taxpayers may ask themselves to determine if they've used an abusive tax shelter transaction:

- Is the tax loss, deduction, or credit a significant amount compared to your investment, and is it used to offset income from unrelated transactions?
- Is your economic and out-of-pocket loss minimal compared to the tax benefits realized?
- Does the transaction lack a business purpose other than reduction of taxes?
- Does the transaction lack a reasonable possibility of making a profit?
- Are multiple entities involved to unnecessarily complicate the transaction?
- Does the tax position ignore the true intent of relevant statutes and regulations?
- Does the transaction produce a tax result that seems too good to be true?

If you answered "yes" to any of the above questions, you are potentially involved in an abusive tax shelter.

What benefits do I receive if I participate in the Tax Shelters Voluntary Compliance Program?
If you participate in the program, the Department of Revenue will waive any civil or criminal penalties that would otherwise apply, including the new penalties enacted by 2007 Wisconsin Act 20 relating to disclosing reportable transactions. These penalties may otherwise include one or more of the following:

- $30,000 for failure to disclose a listed transaction.
- 30% of a tax understatement attributable to a listed or reportable transaction, plus an additional penalty equal to 100% of the interest assessed on the tax computed on the understatement.
- 25% of a tax understatement attributable to negligently filing an incorrect return or failing to file a return.
- 100% of a tax understatement attributable to intent to defeat or evade taxes.
- $10,000 for willful failure to file a return.

Additionally, if you voluntarily disclose an abusive tax shelter that is eligible for this program and is also a reportable transaction, but you wait until after May 31, 2008 to disclose it, you may be subject to a penalty of 20% of any tax understatement attributable to the reportable transaction, plus an additional penalty equal to 50% of the interest assessed on the tax computed on the understatement.

Who can participate?
Any individual, corporation, S corporation, LLC, partnership, or trust which used a tax shelter to:

- reduce the taxpayer's Wisconsin income or franchise tax liability for a taxable year beginning before January 1, 2007,
- increase the taxpayer's Wisconsin loss or credit carryforward for a taxable year beginning before January 1, 2007,
- cause the taxpayer not to file Wisconsin income or franchise tax returns which would otherwise be required for a taxable year beginning before January 1, 2007, or
- for a pass-through entity, to do any of the above with respect to a partner, member, shareholder, or beneficiary of the pass-through entity.

Will I have to waive my appeal rights?
In general, yes, but only with respect to the tax shelter transaction for which you are participating in this program. However, if the IRS grants an appeal or claim for refund with respect to the tax shelter transaction, Wisconsin will allow an appeal or claim for refund that corresponds to the one allowed by the IRS.

How do I participate?

- Complete an amended (or original) Wisconsin return for each year in which the tax avoidance transaction reduced Wisconsin income or franchise tax liability or caused nonfiling of Wisconsin returns.

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- If the tax avoidance transaction required Form 8886 (Reportable Transaction Disclosure Statement) for federal income tax purposes, submit a copy of federal Form 8886 and provide details of the transaction. If the tax avoidance transaction did not require Form 8886 for federal income tax purposes, provide details of the transaction.

- Complete Wisconsin Form WI-VCP, which appears at the end of this bulletin.

- Enclose a check for full payment of the unpaid tax and interest.

- Send the above items to: Wisconsin Department of Revenue, Tax Shelters Program, P.O. Box 8958, Madison, WI 53708-8958.

Didn't Wisconsin already do this?
Wisconsin participated in the Multistate Tax Commission's (MTC's) Multistate Tax Shelter Voluntary Compliance Initiative from May 1, 2007 through October 1, 2007. Through that program, Wisconsin offered to waive all penalties otherwise attributable to tax underpayments resulting from a tax shelter. However, the MTC's program was before Wisconsin enacted the new reportable transaction disclosure requirements. Wisconsin's current program offers taxpayers an additional opportunity to review their past returns and disclose any abusive tax shelters that are "reportable transactions" before the additional penalties for failure to disclose those transactions take effect.

About the New Disclosure Requirements for Taxpayers...

What am I required to disclose to Wisconsin?
You are required to disclose transactions that are classified as "reportable transactions" for federal income tax purposes. A reportable transaction is one that the IRS requires to be separately disclosed because it has a higher potential to be a tax avoidance transaction. The IRS requires reportable transactions to be disclosed on Form 8886, Reportable Transaction Disclosure Statement. The instructions to Form 8886 (available at www.irs.gov) provide a specific explanation of what transactions must be disclosed on the form. In general, these transactions include:

- *Listed transactions*, which the IRS has specifically identified as tax avoidance transactions. Examples include "Sale-in Lease-out" and "Loss Importation" transactions, but there are many others. A complete listing of these transactions is available on the IRS web site at www.irs.gov/businesses/corporations under the heading for "Abusive Tax Shelters."

- *Confidential transactions*, which include transactions offered under conditions of confidentiality and for which you paid an advisor a minimum fee.

- *Transactions with contractual protection*, which are transactions for which the fees depend on whether the intended tax benefits from the transaction are sustained.

- *Loss transactions* which exceed certain thresholds.

- *Transactions of interest*, which are those the IRS identifies as having the potential to become listed transactions but does not have enough information to make the determination.

- *Transactions with a significant book-tax difference* (if prior to January 6, 2006).

- *Transactions with a brief asset holding period* (if prior to August 3, 2007).

For what periods do I have to disclose reportable transactions to Wisconsin?
You must disclose a reportable transaction to Wisconsin if any of the following apply:

- The reportable transaction was entered into on or after January 1, 2001.

- The reportable transaction was entered into before January 1, 2001, but reduced your Wisconsin tax liability for taxable years beginning on or after January 1, 2001.

You are not required to disclose a reportable transaction for which, as of December 26, 2007, the statute of limitations has expired.

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What form do I use to disclose a reportable transaction to Wisconsin?
All you need is a copy of the Form 8886 you submitted to the IRS. For listed transactions that occurred prior to 2003, use the same form you used to disclose the transaction to the IRS.

What if I'm not required to file a Wisconsin income or franchise tax return?
You are not required to disclose reportable transactions to Wisconsin. The requirement only applies to taxpayers otherwise required to file a Wisconsin income or franchise tax return.

For corporations, how should a member of a consolidated group make the disclosure?
A member of a consolidated group is required to submit a copy of the federal form to Wisconsin only for reportable transactions that affect the Wisconsin tax liability of the member on a deconsolidated basis.

When do I have to make the disclosure to Wisconsin?

- For transactions entered into before 2007, the deadline is **May 31, 2008**. This is also the last day of the Tax Shelters Voluntary Compliance Program.
- For transactions entered into on or after January 1, 2007, the deadline is **60 days** after the date required by the IRS for filing Form 8886. For federal purposes, Form 8886 is due on the due date of the federal income tax return (including extensions).

Where do I send my Wisconsin disclosure statements?
Send the Wisconsin disclosures to:

Wisconsin Department of Revenue
Tax Shelters Program
P.O. Box 8958
Madison, WI 53708-8958

What penalties apply to taxpayers if they fail to follow these requirements?
Penalties may apply for failure to disclose a reportable transaction to Wisconsin even if there is no understatement of tax. These penalties are as follows:

- For failure to disclose a listed transaction, $30,000.
- For failure to disclose a reportable transaction that is not a listed transaction, $15,000 or 10% of the tax benefit obtained from the transaction, whichever is less. However, the penalty only applies to such transactions entered into after October 27, 2007.

For reportable transactions entered into on or before October 27, 2007, there is no penalty for failure to disclose a reportable transaction that is not a listed transaction as long as there is no understatement of Wisconsin tax attributable to the transaction.

If there is an understatement of Wisconsin tax attributable to any reportable transaction entered into on or after January 1, 2001 (or entered before that date and affecting a taxable year beginning on or after that date), the following penalties may apply:

- 20% of the understatement if the reportable transaction is disclosed.
- 30% of the understatement if the reportable transaction is not disclosed.

If a reportable transaction was not a listed transaction when I entered into it but the IRS later identified it as a listed transaction, is it still considered a listed transaction?
Yes. For purposes of these requirements and the associated penalties, Wisconsin would treat the transaction as a listed transaction.

Are there other consequences for failing to follow these requirements?
If you fail to disclose a reportable transaction as required, the statute of limitations may be extended with respect to that transaction, as follows:

- For an undisclosed reportable transaction that is not a listed transaction, the statute of limitations is extended to 6 years beyond the filing date of the Wisconsin return for the year the transaction occurred.
- For an undisclosed listed transaction discovered by the Department more than 6 years beyond the filing date of the Wisconsin return for the year the

transaction occurred, the statute of limitations is extended to 4 years after the date the Department discovers the undisclosed transaction.

About the New Disclosure Requirements for Material Advisors...

Who is a "material advisor"?
Any person who provides material aid, assistance or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction and who derives income from these services in an amount that exceeds the following:

- If the services are provided to an individual, $50,000. This threshold reduces to $10,000 if the reportable transaction is a listed transaction.
- If the services are provided to an entity and not an individual, $250,000. This threshold reduces to $25,000 if the reportable transaction is a listed transaction.

What is a material advisor required to disclose to Wisconsin?
A material advisor is required to disclose to Wisconsin any reportable transaction for which the material advisor provided services to a taxpayer who is required to file a Wisconsin income or franchise tax return.

Additionally, a material advisor must maintain a list identifying the name and taxpayer identification number of each Wisconsin taxpayer for whom the advisor provided services as a material advisor regarding a reportable transaction, and must provide the list at the Wisconsin Department of Revenue's written request. This list must be maintained for seven years after the date the services were provided.

What form does a material advisor use to disclose a reportable transaction to Wisconsin?
The material advisor should submit a copy of the federal form used to disclose the transaction to the IRS. Depending on when the transaction took place, that form may be Form 8918, Material Advisor Disclosure Statement, or Form 8264, Application for Registration of a Tax Shelter. There is no specific form required for the list of Wisconsin taxpayers affected by the reportable transaction.

For what periods does a material advisor have to disclose reportable transactions to Wisconsin?
For reportable transactions that are not listed transactions (and have not subsequently become listed transactions), only transactions for which the material advisor provided services after October 27, 2007 must be disclosed to Wisconsin. This also applies to the requirement to maintain the list of Wisconsin taxpayers affected by a reportable transaction.

For listed transactions, a material advisor must disclose to Wisconsin the transactions for which the material advisor provided services on or after January 1, 2001, or before January 1, 2001 if the transaction affected a taxpayer's Wisconsin tax liability for a taxable year beginning on or after January 1, 2001.

When does a material advisor have to make the disclosure to Wisconsin?
The IRS currently requires these disclosures by the last day of the month following the end of the applicable calendar quarter. The federal due date may be January 31, April 30, July 31, or October 31. The due dates for Wisconsin disclosures are shown below:

- For material advisor forms due to the IRS on October 31, 2007, the deadline for sending a copy to Wisconsin is **March 31, 2008**.
- For material advisor forms due to the IRS before October 31, 2007, the deadline for sending a copy to Wisconsin is **May 31, 2008**.
- For material advisor forms due to the IRS on or after January 31, 2008, the deadline for sending a copy to Wisconsin is **60 days** after the federal due date for the form.

Where does a material advisor send Wisconsin disclosure statements?
Material advisors should send the Wisconsin disclosures to:

Wisconsin Department of Revenue
Tax Shelters Program
P.O. Box 8958
Madison, WI 53708-8958

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What penalties apply to material advisors if they fail to follow these requirements?

- $100,000 for a material advisor's failure to disclose a listed transaction.
- $15,000 for a material advisor's failure to disclose a reportable transaction that is not a listed transaction.
- $10,000 for each day the material advisor does not provide the list of affected Wisconsin taxpayers, beginning with the 21st day after receipt of the Department's request for the list.

Are there other consequences that may apply to material advisors relating to abusive tax shelters? Effective October 27, 2007, any person who organizes or assists in organizing a tax shelter or participates in the sale of any interest in a tax shelter, and who makes a statement that the person knows or has reason to know is false or fraudulent regarding the allowability of tax benefits to be achieved with the tax shelter, is subject to a penalty in an amount of 50% of the person's gross income derived from such act.

How Can I Obtain More Information?

For more information on the **Tax Shelters Voluntary Compliance Program**, visit the Department of Revenue's web site at www.revenue.wi.gov, or contact the Department as indicated below:

E-mail: wivoldis@revenue.wi.gov

Phone: (608) 266-3969

Fax: (608) 267-0834

For more information on the requirements to disclose **reportable transactions**, visit the Department of Revenue's web site at www.revenue.wi.gov, or contact the Department as indicated below:

E-mail: corp@revenue.wi.gov

Phone: (608) 266-7177

Fax: (608) 267-0834