LAW OFFICE OF WM. MARK SCOTT PLLC
SCOTTPLLC.COM

MARK SCOTT, ESQ.
202.256.6295
MARK@SCOTTPLLC.COM

April 20, 2020

Tamera L. Ripperda
Commissioner, Tax-Exempt and Government Entities Division SE:T
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, DC 20224

Dear Ms. Ripperda,

Many state and local governments are under financial stress. The Office of Tax Exempt Bonds can help by redirecting examination resources from bond examinations conducted at the governmental issuer level to promoter investigations.

Many of the promoter investigations are long overdue, but the happenstances surrounding this delay enable a greater adjustment in favor of state and local governments today.

Your response to the Treasury Inspector General for Tax Administration's (TIGTA) report "Bond Promoter Misconduct Procedures Should Be Improved," suggests the opposite as a near universal course of action. In particular, you suggest promoter investigations should be rare. You further imply that the facts necessary to bring such actions are not evident. As discussed below, your response inaccurately portrays both the law and facts. The Office of Tax Exempt Bonds can, today, easily reallocate a substantial percentage of its examination resources from bond examinations to promoter investigations.

In your response, you state:

> [S]trict procedures for pursuing § 6700 penalties are consistent with the fact that in enacting the § 6700 statute, Congress limited it by a high threshold because "it believed that such a limited penalty will prevent any unintended application." JCS-38-82 (1982) at 211, *accord* S. Rept. 97-494, 1, 267 (1982). Given this high threshold, the promoter penalty is unlikely to be relevant in most tax-advantaged bond cases.

The quoted language can be found at the bottom of numbered page 211 (attached) of the Joint Committee on Taxation's General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982. It is part of a paragraph in the "1982 Blue Book" describing the 200% gross valuation overstatement.

> A gross valuation overstatement is any statement or representation of the value of the services or property which exceeds 200 percent of the correct value of the property or services and which is directly related to the amount of any income tax

deduction or credit allowable to any participant. Although the valuation error must be more substantial than that required before the valuation overstatement penalty applies to the investor, Congress *believed that such a limited penalty will prevent any unintended application*. (emphasis added.)

The specific 1982 Blue Book language refers to the fact that Congress limited the scope of IRC § 6700 promoter penalty applicable to valuation overstatements by applying a 200% threshold. This 200% gross valuation overstatement threshold can be found in subparagraph (B) of IRC § 6700(a)(2) (attached).

Importantly, the quoted 1982 Blue Book language neither requires nor supports imposing a high threshold against the institution of promoter investigations tied to exempt bond issues. The 1982 Blue Book language relates solely to *subparagraph (B)* of IRC § 6700(a)(2). The usual and preferred analysis for exempt bond promoter investigations is to apply *subparagraph (A)* of IRC § 6700(a)(2) based on a material false statement. In point of fact, the I.R.S. exempt bond training program only addresses the use of subparagraph (A). *See* Internal Revenue Service, *TEB Phase III – Lesson 6, Section 6700 Penalty*, pp. 6-1, 6-3 to 6-8 (undated), https://www.irs.gov/pub/irs-tege/teb3_lesson6.pdf.

In footnote 1 of your response, for instance, you refer supportively to the IRC § 6700 promoter investigations of persons involved in bid-rigging of guaranteed investment contracts (GICs). When the Office of Tax Exempt Bonds opened IRC § 6700 investigations of the bankers and banking organizations promoting the GIC bid-rigging scheme, we relied exclusively on subparagraph (A) of IRC § 6700(a)(2) (the making of a material false statement), even though the material false statements related to the fair market value of the GICs. The initiation of these promoter investigations under subparagraph (A) was straightforward and thoroughly supported by then existing law. In fact, it was these promoter investigations of bankers and banking organizations for their material false statements regarding the value of the GICs that were referred in 2005 to the Department of Justice and led directly to criminal proceedings by its Antitrust Division and tag-along separate proceedings by the Securities and Exchange Commission and Office of the Comptroller of the Currency. *See* TIGTA, *The Tax Exempt and Government Entities Division is Making Progress to Detect and Deter Fraud Within its Customer Base, But the Impact Cannot Be Determined at This Time*," pp. 1, 16 (Sep. 2005). You therefore negate your own argument by positively referring to the GIC bid-rigging investigations.

The same legal analysis applied to the initiation of promoter investigations related to GIC bid-rigging would apply today as Congress has not materially changed the relevant provisions of subparagraph (A) of IRC § 6700(a)(2) since the date those investigations were approved.

As such, it is both legally incorrect and historically inaccurate to cite to the quote in the 1982 Blue Book describing the reasons why Congress set a 200% threshold in subparagraph (B) of IRC § 6700(a)(2) as support for the proposition that IRC § 6700 penalty examinations are "unlikely to be relevant in most tax-advantaged bond cases" due to a Congressionally-imposed "high threshold."

Indeed, instead of trying to hinder the use of IRC § 6700 penalty examinations in exempt bond matters, Congress specifically identified parties to an exempt bond transaction as persons it

expects the I.R.S. to investigate pursuant to IRC § 6700. And, in doing so, Congress specifically referred to investigations based on subparagraph (A) material false statements, not subparagraph (B) overstatements of value. The 1989 House report (attached) states:

> The penalty imposed by section 6700 may apply to bond counsel, investment bankers and their counsel, issuers (and beneficiaries of "conduit" bonds) and their counsel, financial advisors, feasibility consultants and engineers, and other persons, who (1) are involved in the organization or sale such State or local government bonds and (2) **know or have reason to know that their opinions, offering documents, reports, or other statements** (or materials on which they relied in making such statements) **are false or fraudulent as to any matter material** to the tax exemption of the interest on the bonds.

H.R. Rep. No. 247, 101st Cong., 1st Sess. 1, 1397-98 (1989) (emphasis added).

This clear message from Congress was reinforced by the Government Accountability Office in 1993.

> Section 6700 may provide IRS with a more appropriate penalty for tax-exempt bond abuses than taxing bondholders' interest or reaching closing agreements with issuers because it has attributes that may encourage voluntary compliance.

Government Accountability Office, *Improvements for More Effective Tax-Exempt Bond Oversight*, GAO/GGD-93-104, pp. 1, 46 (May 10, 1993). *See, also*, Advisory Committee on Tax Exempt and Government Entities, *Report of Recommendations*, Publication 4344, pp. 1, 6 (Jun. 9, 2004) ("We encourage TE/GE to train agents in use of enforcement tools such as Section 6700 (promoter penalties)"); New York State Bar Association, Tax Section, *Report on Application of Section 6700 Penalties to Lawyers: The "Reason to Know" Standard*, pp. 1, 25 (Jan. 10, 2005) ("there are circumstances under which a [Section 103 tax] lawyer's failure to exercise ordinary care may lead to the making of statements or the rendering of opinions that are materially false and that such inadequate conduct is appropriately the subject of Section 6700 penalties.").

The recent TIGTA report finds that the Office of Tax Exempt Bonds has not opened a promoter investigation since before September, 2017. *Compare* TIGTA, Mar. 2020 Report, at 4, *with* TIGTA, Sep. 2005 Report at 16 ("TEB office has approximately 100 potentially abusive cases under investigation and approximately 38 current ongoing investigations involving I.R.C. § 6700 into abusive transactions. . . . [and] has referred eight attorneys to the Office of Professional Responsibility"). TIGTA also reports that the Office of Tax Exempt Bonds has not been pursuing "potential organizer or participant noncompliance reported by external sources." *Compare* TIGTA, Mar. 2020 Report, at 10, *with* TIGTA, Sep. 2005 Report, at 16 ("The TEB office used a variety of techniques to identify abusive schemes, abusive transactions, and/or fraud.").

Your response implies that current examination results support the lack of promoter investigations. Yet I.R.S. bond agents developed or corroborated the existence of material false

statements years ago, several years before the period of time reviewed by TIGTA.[1] In fact, the Office of Tax Exempt Bonds has sufficient evidence to initiate multiple promoter investigations based on, once again, material false statements by bankers regarding the value of financial instruments. These investigations are not time barred. And, similarly to the GIC bid-rigging investigations, the material false statements are part of an ongoing pattern of fraudulent behavior by a small group of bankers working for various corporate banking institutions. This pattern is ongoing in that these same bankers are continuing to deploy this same fraud and lawyers opining on these transactions are often failing to exercise ordinary care.

To summarize, promoter investigations move the burden involved in examination activities from governmental issuers to the actual wrongdoers. For this reason, Congress expects the I.R.S. to initiate promoter investigations under IRC § 6700 where appropriate. Both the Government Accountability Office and private practitioners have opined that this is a preferable use of examination resources. Current times only strengthen their arguments.

You assert a "high threshold" must be met before the I.R.S. can initiate an exempt bond promoter investigation. As support, you cite 1982 Blue Book language relating to subparagraph (B) of IRC § 6700(a)(2). As shown by the I.R.S.'s "Phase III" bond training, subparagraph (B) is largely irrelevant for exempt bond promoter investigations, which are typically based on subparagraph (A) of IRC § 6700(a)(2) (material false statements). The use of subparagraph (A) to initiate bond promoter investigations has technical merit, has received especially strong support from Congress, and has significant historic precedent. The use of subparagraph (A) is not subject to the "high threshold" referred to in your response. As such, a "high threshold" bar should not be part of the process of determining when to pursue exempt bond promoter investigations.

Your Office of Tax Exempt Bonds has sufficient evidence to open multiple promoter investigations based on material false statements relating to the abusive promotion of exempt bonds, including false statements that have already been developed or corroborated by I.R.S. bond agents. Following up on these false statements with promoter investigations would result in a reallocation of examination resources from state and local governments, many of whom are in financial difficulties, to the actual wrongdoers, who are not in financial trouble.

[1] I.R.S. enforcement records prepared by I.R.S. agents working within the Government Entities office are typically readily available under most state public records laws. *Cf., William Mark Scott v. City of Tampa*, Case No. 16-CA-00257-61 (Fla. Cir. Ct, 13th Dist. 2016) (approving settlement releasing I.R.S. examination records sent to and received by the City of Tampa); *William Scott v. District of Columbia*, Civil Case No. 2018 CA 002275 B (DC Sup. Ct., 2018) (requiring D.C. to release records received during I.R.S. examination).

Should you decide to re-allocate your examination resources toward wrongdoers and away from financially-troubled governmental issuers, I stand prepared to assist, if necessary and as requested. My contact information is provided above.

Very truly yours,

LAW OFFICE OF WM. MARK SCOTT PLLC

____

Wm. Mark Scott

Attachments:
I.R.C. § 6700
JCS-38-82 (1982) (relevant pages)
H.R. Rep. No. 247 (1989) (relevant pages)

cc: Michael E. McKenney
Deputy Inspector General for Audit
Treasury Inspector General for Tax Administration

Allyson Belsome
Director, Office of Tax Exempt Bonds
Internal Revenue Service

26 U.S. Code § 6700. Promoting abusive tax shelters, etc.

U.S. Code Notes

(a) Imposition of penalty Any person who—

(1)

(A) organizes (or assists in the organization of)—

(i) a partnership or other entity,

(ii) any investment plan or arrangement, or

(iii) any other plan or arrangement, or

(B) participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement referred to in subparagraph (A), and

(2) makes or furnishes or causes another person to make or furnish (in connection with such organization or sale)—

(A) a statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or

(B) a gross valuation overstatement as to any material matter,

shall pay, with respect to each activity described in paragraph (1), a penalty equal to $1,000 or, if the person establishes that it is lesser, 100 percent of the gross income derived (or to be derived) by such person from such activity. For purposes of the preceding sentence, activities described in paragraph (1)(A) with respect to each entity or arrangement shall be treated as a separate activity and participation in each sale described in paragraph (1)(B) shall be so treated. Notwithstanding the first sentence, if an activity with respect to which a penalty imposed under this subsection involves a

statement described in paragraph (2)(A), the amount of the penalty shall be equal to 50 percent of the gross income derived (or to be derived) from such activity by the person on which the penalty is imposed.

(b) Rules relating to penalty for gross valuation overstatements

(1) Gross valuation overstatement defined For purposes of this section, the term "gross valuation overstatement" means any statement as to the value of any property or services if—

(A) the value so stated exceeds 200 percent of the amount determined to be the correct valuation, and

(B) the value of such property or services is directly related to the amount of any deduction or credit allowable under chapter 1 to any participant.

(2) Authority to waive
The Secretary may waive all or any part of the penalty provided by subsection (a) with respect to any gross valuation overstatement on a showing that there was a reasonable basis for the valuation and that such valuation was made in good faith.

(c) Penalty in addition to other penalties
The penalty imposed by this section shall be in addition to any other penalty provided by law.

(Added Pub. L. 97–248, title III, § 320(a), Sept. 3, 1982, 96 Stat. 611; amended Pub. L. 98–369, div. A, title I, § 143(a), July 18, 1984, 98 Stat. 682; Pub. L. 101–239, title VII, § 7734(a), Dec. 19, 1989, 103 Stat. 2403; Pub. L. 108–357, title VIII, § 818(a), Oct. 22, 2004, 118 Stat. 1584; Pub. L. 115–141, div. U, title IV, § 401(a)(314), Mar. 23, 2018, 132 Stat. 1199.)

U.S. Code Toolbox

Law about... Articles from Wex

John B

[JOINT COMMITTEE PRINT]

GENERAL EXPLANATION

OF THE

REVENUE PROVISIONS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

(H.R. 4961, 97TH CONGRESS; PUBLIC LAW 97-248)

PREPARED BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

DECEMBER 31, 1982

Revenue Service establishes fraud by a promoter, the investors may be materially aided in their efforts to seek rescission of the contracts under which they invested. Finally, the promoter penalty was viewed as particularly equitable because the promoter, professional advisor or salesman of a tax shelter generally is more culpable than the purchaser who may have relied on their representations as to the tax consequences of the investment.

Explanation of Provision

The Act imposes a new civil penalty on persons who organize, assist in the organization of, or participate in the sale of any interest in a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement when, in connection with such organization or sale, the person makes or furnishes either (1) a statement which the person knows or has reason to know is false or fraudulent as to any material matter with respect to the availability of any tax benefit alleged to be allowable by reason of participating in the entity, plan or arrangement, or (2) a gross valuation overstatement as to a matter material to the entity, plan or arrangement, whether or not the accuracy of the statement of valuation is disclaimed. Thus, persons subject to the penalty may include not only the promoter of a classic tax shelter partnership or tax avoidance scheme, but any other person who organizes or sells a plan or arrangement with respect to which there are material inaccuracies affecting the tax benefits to be derived from participation in the arrangement. For example, the penalty could apply to some one organizing or selling an investment to or for a particular client. Moreover, the plan or arrangement need not be an investment; the term includes other activities such as the sale of mail-order ministries or family trust arrangements. A matter is material to the arrangement if it would have a substantial impact on the decision making process of a reasonably prudent investor.

The "knows or has reason to know" standard clarifies that the Secretary may rely on objective evidence of the knowledge of a promoter or salesperson (for example) to prove that he deliberately furnished a false or fraudulent statement. For example, a salesman would ordinarily be considered to have knowledge of the facts revealed in the sales materials which are furnished to him by the promoter. The "knows or has reason to know standard" was not, however, intended by Congress to be used to impute knowledge to a person beyond the level of comprehension required by his role in the transaction. Thus, this standard does not carry with it a duty of inquiry concerning the transaction beyond that implied by a person's role in the transaction.

A gross valuation overstatement is any statement or representation of the value of services or property which exceeds 200 percent of the correct value of the property or services and which is directly related to the amount of any income tax deduction or credit allowable to any participant. Although the valuation error must be more substantial than that required before the valuation overstatement penalty applies to the investor, Congress believed that such a limited penalty will prevent any unintended application. The pen-

alty for gross valuation overstatement will have no effect on bona fide commercial or investment transactions in which, for example, a willing and knowledgeable buyer purchased from a willing and knowledgeable seller for cash because such a purchase price will define the value of the investment.

The penalty for promoting an abusive tax shelter is an assessable penalty equal to the greater of $1,000 or 10 percent of the gross income derived, or to be derived, from the activity. There need not be reliance by the purchasing taxpayer or actual underreporting of tax. These elements were not included because they would substantially impair the effectiveness of this penalty. Thus, a penalty can be imposed based upon the offering materials of the arrangement without an audit of any purchaser of interests. If the Internal Revenue Service cannot determine the entire amount of the gross income to be derived from an activity, it may assess the penalty on the present value of the portion of such gross income that may be determined. In determining the penalty with respect to the amount of gross income yet to be derived from an activity, the Secretary may look only to unrealized amounts which the promoter or other person may reasonably expect to realize.

The Secretary is given authority to waive all or part of any penalty resulting from a gross valuation overstatement, upon a showing that there was a reasonable basis for the valuation and the valuation was made in good faith. The mere existence of an appraisal is not sufficient, by itself, to show either reasonable basis or good faith. Rather, the Secretary may, for example, examine the basis for the appraisal, the manner in which it was obtained, and the appraiser's relationship to the investment or promoter.

This penalty is in addition to all other penalties provided for by law.

Effective Date

This provision took effect on the day after the date of enactment.

b. Action to enjoin promoters of abusive tax shelters, etc. (sec. 321 of the act and new sec. 7408 of the Code)*

Prior Law

Under prior law and present law, a civil action may be brought by the United States to enjoin any person who is an income tax return preparer from (1) engaging in any conduct subject to penalty under the income tax return preparer provisions or under the criminal tax laws, (2) misrepresenting his qualifications, (3) guaranteeing a refund or credit, or (4) engaging in any other fraudulent or deceptive conduct that substantially interferes with the proper administration of the tax laws. Venue for such an action lies in the district in which the income tax return preparer resides or has his principal place of business, or the taxpayer with respect to whose income tax return the action is brought resides. Injunctive relief may be granted by the district court if the court finds that such

*For legislative background of the provision, see: H.R. 4961, as reported by the Senate Finance Committee, sec. 332; S. Rep. No. 97-494, Vol. 1 (July 12, 1982), pp. 268-269; and H. Rep. No. 97-760 (August 17, 1982), pp. 523 (Joint Explanatory Statement of the Committee of Conference).

OMNIBUS BUDGET RECONCILIATION ACT OF 1989

REPORT

OF THE

COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES

TO ACCOMPANY

H.R. 3299

A BILL TO PROVIDE FOR RECONCILIATION PURSUANT TO SECTION 5 OF THE CONCURRENT RESOLUTION ON THE BUDGET FOR THE FISCAL YEAR 1990

together with

SUPPLEMENTAL AND ADDITIONAL VIEWS

September 20, 1989.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
21-826 WASHINGTON : 1989

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, DC 20402

Digitized by Google
Original from
THE OHIO STATE UNIVERSITY

that there was no intentional disregard of rules and regulations for purposes of the negligence penalty, also apply to this penalty.

The return preparer penalties that apply to each failure to (1) furnish a copy of a return or claim for refund to the taxpayer, (2) sign the return or claim for refund, (3) furnish his or her identifying number, and (4) file a correct information return, are made uniform. The penalty is $50 for each failure and the total penalties imposed for any single type of failure for any calendar year are limited to $25,000.

Penalty for promoting abusive tax shelters

Under the bill, the amount of the penalty imposed for promoting abusive tax shelters equals $1,000 (or, if the person establishes that it is less, 100 percent of the gross income derived or to be derived by the person from such activity). In calculating the amount of the penalty, the organizing of an entity, plan or arrangement and the sale of each interest in an entity, plan, or arrangement constitute separate activities. The committee has made these modifications because the courts have differed in their interpretations of the provisions of present law. The committee believes that its modifications will eliminate confusion for cases arising in the future. The bill also clarifies that the penalty applies to direct or indirect actions.

The committee is concerned about the large number of old tax shelter cases that await resolution. The committee recognizes that the Tax Court has, in the last several years, made significant progress in reducing its inventory of old tax shelter cases. The committee expects the Tax Court as well as the IRS to redouble their efforts to resolve or encourage settlement of old tax shelter cases. The committee realizes that delay is often caused by the litigants themselves. The committee encourages the Tax Court to use every means within its disposal, including the sanctions on litigants and attorneys imposed under this bill, to encourage litigants to resolve their disputes as expeditiously as possible. Similarly, the committee encourages the IRS to make every effort to resolve old tax shelter cases, through means such as additional settlement initiatives, better caseload management, and better utilization of the appeals process.

The committee wishes to clarify that, under present law, "investment plan or arrangement" and "other plan or arrangement," as those terms are used in section 6700 of the Code, include obligations issued by or on behalf of State or local governments which are represented to be described in section 103(a) of the Code ("bonds").[87] Therefore, the penalty imposed by section 6700 may apply to bond counsel, investment bankers and their counsel, issuers (and beneficiaries of "conduit" bonds) and their counsel, financial advisors, feasibility consultants and engineers, and other persons, who (1) are involved in the organization or sale of such State or local government bonds and (2) know or have reason to know

---

[87] For purposes of determining whether an obligation is represented as so described, qualifications or conditions with respect to the opinion of the bond counsel for the issue which are commonly accepted in the marketplace are not to be considered. For example, an obligation could still be represented to be described in section 103(a), even though bond counsel's opinion assumed continuing compliance with certain requirements of the Code (*e.g.*, arbitrage rebate).

Digitized by Google

Original from
THE OHIO STATE UNIVERSITY

that their opinions, offering documents, reports, or other statements (or material on which they relied in making such statements) are false or fraudulent as to any matter material to the tax exemption of the interest on the bonds. A person who makes a statement facilitating the issuance or sale of State or local government bonds (including a sale occurring subsequent to the issuance of the bonds) is involved in the organization or sale of such bonds.

Whether a person who makes or furnishes or causes another person to make or furnish a statement in connection with the organization or sale of bonds (including a statement that interest on the bonds is exempt from taxation), knows or has reason to know that such person's statement is false or fraudulent as to any material matter depends upon that person's role in the organization or sale. For example, bond counsel, issuer's counsel, and underwriters' counsel would be entitled to reply upon a feasibility study conducted by an engineering firm reputed to be expert in the subject matter and area of the study, unless such counsel independently knew or had reason to know information bringing into question the results of that study. Absent that, counsel would not be required to question the assumptions underlying, or results reached by, the study. Similarly, bond counsel would be able to rely, as to matters of fact or expectation relevant to his or her opinion, on information provided by other parties (including the issuer) absent actual knowledge or a reason to know of its inaccuracy or the use of statements not credible or reasonable on their face. On the other hand, bond counsel must draw their own legal conclusions from that information. For example, bond counsel may rely on an engineer's description of a facility as to its physical characteristics, operations, functions, and performance, but would not be able to rely on such certification for counsel's legal conclusion that the facility qualified under section 142 of the Code. Similarly, an investment banking firm organizing or assisting in the organization of the bonds holding itself out as expert in the particular subject area of the financing would have reason to question the conclusion of a feasibility consultant if that consultant's report omitted consideration of a principal factor typically discussed in feasibility reports used in such financings (*e.g.*, competition for a project's source of supply of materials).

In addition, section 6700 applies even if the Service has insulated bondholders from the effect of a declaration of taxability of a bond sold as tax-exempt by entering into a closing agreement with the issuer of the bonds.[88] Furthermore, so long as there has been a determination that a false or fraudulent statement (which may include a conclusion of law based on a false or fraudulent statement) has been utilized, action under section 6700 is not precluded by failure of the Service to enter into a closing agreement, to declare taxability, or otherwise to penalize the issuer or owners of the bonds in question. In addition, action may be taken under section 6700

[88] Such closing agreements generally provide that the Service will not tax the interest earned by the bondholders in exchange for certain actions by the issuer, including in some cases payment designed to compensate the Federal Government for all or an appropriate percentage of lost tax revenues.

Digitized by Google

Original from
THE OHIO STATE UNIVERSITY

prior to delivery of bonds if a false or fraudulent statement is being used in their offering.

Penalty for aiding and abetting the understatement of tax liability

The bill amends the penalty for aiding and abetting the understatement of tax liability by imposing the penalty in cases where the person aids, assists in, procures, or advises with respect to the preparation or presentation of any portion of a return or other document if (1) the person knows or has reason to believe that the return or other document will be used in connection with any material matter arising under the tax laws, and (2) the person knows that if the portion of the return or other document were so used, an understatement of the tax liability of another person would result. In addition, the bill provides that a penalty for promoting abusive tax shelters is not to be imposed on any person with respect to any document if an aiding and abetting penalty is imposed on such person with respect to the same document. Both penalties may however be imposed with respect to separate documents, such as, for example, when a promoter furnishes promotional material at the time of sale and subsequently provides partnership schedules (Forms K-1) to the investors. The committee believes that this penalty should not be used as a means of avoiding the procedural requirements of a John Doe summons under section 7609(f).

Frivolous income tax return penalty

The bill deletes the special provision in present law permitting taxpayers who contest the imposition of this penalty to pay 15 percent of the penalty, which halts further collection proceedings until final judicial resolution of the dispute. Thus, taxpayers who wish to contest imposition of this penalty must pay the full penalty before seeking judicial review of imposition of the penalty. The committee believes that repealing this special 15-percent rule places taxpayers who contest this penalty by way of a refund action in the same position as taxpayers who contest the assertion that they owe additional tax to the IRS. By repealing this special rule, the bill makes suits for refund of this penalty permissible only under the generally applicable rules on suits for refunds. Suits contesting the imposition of this penalty may be brought only in the district courts and the Claims Court.

Sanctions and costs awarded by courts

The bill authorizes the Tax Court to impose a penalty not to exceed $25,000 if a taxpayer (1) institutes or maintains a proceeding primarily for delay, (2) takes a position that is frivolous, or (3) unreasonably fails to pursue available administrative remedies. The committee intends that the increased penalty (above $5,000) apply primarily (but not exclusively) to tax shelter cases, where the $5,000 maximum provided under present law appears to be ineffective in deterring taxpayers from taking frivolous positions.

The committee has explicitly chosen to call these awards "penalties", rather than "damages" (as under present law), so that it is clear that specific damages incurred by the United States need not be proved before the court may impose this penalty. The committee believes that dealing with these frivolous lawsuits wastes scarce ju-

Digitized by Google Original from THE OHIO STATE UNIVERSITY