

**WEST VIRGINIA  
SECRETARY OF STATE  
BETTY IRELAND  
ADMINISTRATIVE LAW DIVISION**

Form #3

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**NOTICE OF AGENCY APPROVAL OF A PROPOSED RULE  
AND  
FILING WITH THE LEGISLATIVE RULE-MAKING REVIEW  
COMMITTEE**

AGENCY: State Tax Department TITLE NUMBER: \_\_\_\_\_

CITE AUTHORITY W. Va. Code §§ 11-10E-2 & 11-10-5

AMENDMENT TO AN EXISTING RULE: YES \_\_\_\_\_ NO X \_\_\_\_\_

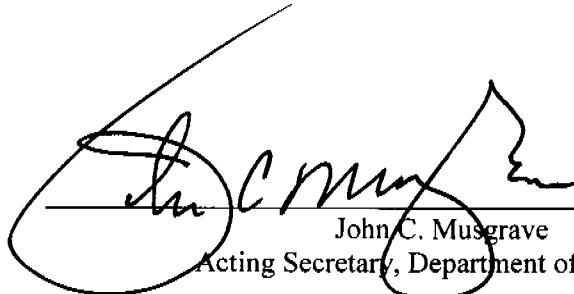
IF YES, SERIES NUMBER OF RULE BEING AMENDED: \_\_\_\_\_

TITLE OF RULE BEING AMENDED: \_\_\_\_\_

IF NO, SERIES NUMBER OF RULE BEING PROPOSED: 10J

TITLE OF RULE BEING PROPOSED: Abusive Tax Shelter

THE ABOVE PROPOSED LEGISLATIVE RULE HAVING GONE TO A PUBLIC HEARING OR A PUBLIC COMMENT PERIOD IS HEREBY APPROVED BY THE PROMULGATING AGENCY FOR FILING WITH THE SECRETARY OF STATE AND THE LEGISLATIVE RULE MAKING REVIEW COMMITTEE FOR THEIR REVIEW.

  
\_\_\_\_\_  
John C. Musgrave  
Acting Secretary, Department of Revenue

**AGENCY APPROVED  
WEST VIRGINIA LEGISLATIVE RULE  
110 C.S.R. 10J  
ABUSIVE TAX SHELTERS  
SUMMARY OF RULE**

§ 110-10J-1. General.

§ 110-10J-2. Purpose.

§ 110-10J-3. Definitions.

§ 110-10J-4. Reportable transactions.

§ 110-10J-5. Participation in a reportable transaction

§ 110-10J-6. Registration of tax shelters.

§ 110-10J-7. Investor lists.

§ 110-10J-8. Penalties.

**AGENCY APPROVED  
WEST VIRGINIA LEGISLATIVE RULE  
110 C.S.R. 10J  
ABUSIVE TAX SHELTERS  
STATEMENT OF CIRCUMSTANCES**

The Legislature, on March 9, 2006, enacted Committee Substitute for House Bill 4630. The purpose of the bill was to establish the Tax Shelter Voluntary Compliance Program to occur between August 1, 2006 and November 1, 2006. The Tax Department will satisfy the requirements of the bill.

The purpose of this rule is to provide the framework within which tax shelters will continue to be regulated after the completion of the Tax Shelter Voluntary Compliance Program. As the subject matter is quite complex, this rule is necessary so as to provide consistency in the regulatory process.

## APPENDIX B

### FISCAL NOTE FOR PROPOSED RULES

Rule Title: Abusive Tax Shelters

Type of Rule: ☒ Legislative ☐ Interpretive ☐ Procedural

Agency: State Tax Department  
 Address: Legal Division  
P.O. Box 1005  
Charleston, WV 25324-1005

#### 1. Effect of Proposed Rule

	ANNUAL FISCAL YEAR				
	INCREASE	DECREASE	CURRENT	NEXT	THEREAFTER
<u>ESTIMATED TOTAL COST</u>	\$ 0	\$ 0	\$ 0	\$ 392,150	\$ 357,150
PERSONAL SERVICES	0	0	0	257,150	257,150
CURRENT EXPENSE	0	0	\$ 0	100,000	100,000
REPAIRS & ALTERNATIONS	0	0	0	0	0
EQUIPMENT	0	0	0	35,000	0
OTHER	0	0	0	0	0

#### 2. Explanation of above estimates:

The above costs are for the establishment of a Tax Shelter Regulation Program to identify and audit Taxpayers who may have used "Abusive Tax Avoidance Transactions" to reduce their West Virginia income tax liability. Through the program, three auditors will be hired to conduct audits of Taxpayers involve din "Abusive Tax Avoidance Transactions." Also, an attorney will be hired to provide legal support to the program.

#### 3. Objectives of these rules:

The rule clarifies the procedures for the on-going Tax Shelter Regulation Program.

RULE TITLE: Abusive Tax Shelters

4. Explanation of Overall Economic Impact of Proposed Rule.

A. Economic Impact on State Government.

Additional revenue to the State as the result of this program will be roughly \$1.25 million.

B. Economic Impact on Political Subdivisions; Specific Industries; Specific groups of Citizens.

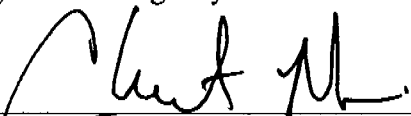
Taxpayers who used an "Abusive Tax Avoidance Transaction" to underreport their West Virginia income tax liability will pay roughly \$1.25 million in tax, interest and penalties.

C. Economic Impact on Citizens/Public at Large.

Minor.

Date: 7-25-06

Signature of Agency Head or Authorized Representative



Virgil T. Helton, Acting State Tax Commissioner

## QUESTIONNAIRE

*(Please include a copy of this form with each filing of your rule: Notice of Public Hearing or Comment Period; Proposed Rule, and if needed, Emergency and Modified Rule.)*

DATE: July 21, 2006

TO: LEGISLATIVE RULE-MAKING REVIEW COMMITTEE

FROM: (Agency Name, Address & Phone No.) Legal Division, State Tax Department, P.O. Box 1005

Charleston, WV 25324-1005

**Contact Person: John Montgomery 558-5330**

**EMERGENCY RULE TITLE: Abusive Tax Shelters**

1. Authorizing statute(s) citation W. Va. Code §§ 11-10E-2 & 11-10-5
2. a. Date filed in State Register with Notice of Hearing or Public Comment Period:  
June 2, 2006
- b. What other notice, including advertising, did you give of the hearing:  
None
- c. Date of Public Hearing(s) *or* Public Comment Period ended:  
June 2, 2006 – July 3, 2006
- d. Attach list of persons who appeared at hearing, comments received, amendments, reasons for amendments.  
Attached \_\_\_\_\_ No comments received X
- e. Date you filed in State Register the agency approved proposed Legislative Rule following public hearing: (be exact)  
June 2, 2006

- f. **Name, title, address and phone/fax/e-mail numbers** of agency person(s) to receive all *written correspondence* regarding this rule: (Please type)

John E. Montgomery, Managing Attorney

P.O. Box 1005, Charleston, WV 25324-1005

Telephone: (304) 558-5330

Fax: (304) 558-8728

JMontgomery@tax.state.wv.us

- g. **IF DIFFERENT FROM ITEM 'f'**, please give **Name, title, address and phone number(s)** of agency person(s) who wrote and/or has responsibility for the contents of this rule: (Please type)

N/A

3. If the statute under which you promulgated the submitted rules requires certain findings and determinations to be made as a condition precedent to their promulgation:

- a. Give the date upon which you filed in the State Register a notice of the time and place of a hearing for the taking of evidence and a general description of the issues to be decided.

N/A

- b. Date of hearing or comment period:

N/A

- c. On what date did you file in the State Register the findings and determinations required together with the reasons therefore:

N/A

d. Attach findings and determinations and reasons:

N/A

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**AGENCY APPROVED  
WEST VIRGINIA LEGISLATIVE RULE  
110 C.S.R. 10J  
ABUSIVE TAX SHELTERS  
COMMENTS**

On June 2, 2006, emergency legislative rule 110 C.S.R. 10J, Abusive Tax Shelters, was filed for public comment.

While no actual comments were received during the comment period, questions were raised during telephone conversations with taxpayer representatives and representatives of material advisors that while monetary penalties may be imposed for failure to maintain investor lists, there was very little if any guidance as to just what comprised an investor list. Because this raised questions as to basic fairness and could have affected the validity of the rule, a definition of "investor lists" was incorporated into the rule. This will provide to taxpayers notice that is appropriate and guidance that will assist in avoiding monetary penalties. Additionally, so as to preclude any confusion between the Commissioner of Internal Revenue and the State Tax Commissioner, a definition for "Commissioner" and "Tax Commissioner" was also incorporated into the rule.

Finally, it also was noted during telephone conversations with taxpayer representatives and representatives of material advisors that the rule was requiring the filing of materials that under certain circumstances were substantially in excess of the filing requirements imposed by the Internal Revenue Service. As a result, Subdivision 8.2.1 was amended to require the filing of the materials that were filed with the I.R.S., therefore providing the procedure for compliance with the requirements of West Virginia Code § 11-10E-8.

**AGENCY APPROVED  
WEST VIRGINIA LEGISLATIVE RULE  
TITLE 110  
SERIES 10J  
ABUSIVE TAX SHELTERS**

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**§ 110-10J-1. General.**

1.1. **Scope** -- This rule provides guidance relating to the disclosure and regulation of tax shelters created to avoid paying state income taxes.

1.2. **Authority** -- West Virginia Code §§11-10E-2 and 11-10-5.

1.3. **Filing Date** --

1.4. **Effective Date** --

**§ 11-10J-2. Purpose.**

2.1. The Tax Commissioner is required by West Virginia Code § 11-10E-2 to establish and administer a tax shelter voluntary compliance program for eligible taxpayers that are subject to either Personal Income Tax imposed under West Virginia Code § 11-21-1 et seq., or Corporation Net Income Tax imposed under West Virginia Code § 11-24-1 et seq. The voluntary compliance program is to be conducted from August 1, 2006 through November 1, 2006. The voluntary compliance program is to apply to personal income tax and corporation net income tax liabilities attributable to the use of tax avoidance transactions for taxable years beginning before January 1, 2006.

2.2. This rule will provide continuing administrative and regulatory guidance over certain tax shelters used to avoid paying West Virginia income tax.

**§ 110-10J-3. Definitions.**

3.1. **General rule.** Terms used in this rule have the meaning ascribed to them in West Virginia Code § 11-10-4, unless the context in which the term is used clearly requires a different meaning, or the term is defined in subsection 3.2 of this rule.

3.2. **Terms defined.** For purposes of this rule, the additional term:

3.2.1. **"Abusive tax schemes"** means transactions promoted for the promise of tax benefits with no meaningful change in the taxpayer's control over or benefit from the taxpayer's income or assets. These transactions typically have no economic purpose other than reducing taxes, or may involve the use of multiple layers of domestic and foreign pass-through entities including: partnerships, S corporations, limited liability companies, and trusts.

3.2.2. "**Commissioner**" or "**Tax Commissioner**" means the West Virginia State Tax Commissioner or his/her delegate.

3.2.3. "**Confidential transactions**" means a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee.

3.2.4. "**Gross valuation overstatement**" means any statement as to the value of any property or services if the value so stated exceeds 200 percent of the amount determined to be the correct valuation, and the value of such property or services is directly related to the amount of any deduction or credit allowable under 26 U.S.C. §§ 1 et seq. to any participant.

3.2.5. "**Investor lists**" means any list required to be maintained under I.R.C. § 6112 and Treasury Regulations Section 301.6112-1 with respect to a potentially abusive tax shelter, and to be considered complete shall at a minimum include the following information:

3.2.5.1. The name of each transaction that is a potentially abusive tax shelter and the registration number, if any, obtained under I.R.C. § 6111;

3.2.5.2. The tax identification number, if any, of each transaction;

3.2.5.3. The name, address, and tax identification number of each person required to be on the list;

3.2.5.4. If applicable, the number of units (i.e., percentage of profits, number of shares, etc.) acquired by each person required to be included on the list;

3.2.5.5. The date on which each interest was acquired;

3.2.5.6. The amount invested in each transaction by each person required to be included on the list;

3.2.5.7. A detailed description of each transaction that describes both the structure and its expected tax consequences;

3.2.5.8. A summary or schedule of the tax consequences that each person is intended or expected to derive from participation in each transaction, if known by the material advisor;

3.2.5.9. Copies of any additional written materials, including tax analyses or opinions, relating to each transaction that have been shown or provided to any person who acquired an interest in the transaction, or their representatives, tax

advisors, or agents, by the material advisor or any related party or agent of the material advisor; and

3.2.5.10. For each person, if the interest in the transaction was not acquired from the material advisor maintaining the list, the name of the person from whom the interest was acquired.

3.2.6. "**Listed transaction**" means a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.

3.2.7. "**Loss transactions**" mean any transaction resulting in the taxpayer claiming a loss under I.R.C. § 165 of at least:

3.2.7.1. \$10,000,000 in any single taxable year or \$20,000,000 in any combination of taxable years for corporations;

3.2.7.2. \$10,000,000 in any single taxable year or \$20,000,000 in any combination of taxable years for partnerships that have only corporations as partners (looking through any partners that are themselves partnerships), whether or not any losses flow through to one or more partners; or \$2,000,000 in any single taxable year or \$4,000,000 in any combination of taxable years for all other partnerships, whether or not any losses flow through to one or more partners;

3.2.7.3. \$2,000,000 in any single taxable year or \$4,000,000 in any combination of taxable years for individuals, S corporations, or trusts, whether or not any losses flow through to one or more shareholders or beneficiaries; or

3.2.7.4. \$50,000 in any single taxable year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership, if the loss arises with respect to a section 988 transaction (as defined in I.R.C. § 988(c)(1) relating to foreign currency transactions).

3.2.8. "**Material Advisor**" means any person who:

3.2.8.1. Must register the transaction as a tax shelter under federal law;

3.2.8.2. Receives, or expects to receive, at least a minimum fee in connection with a transaction that is a potentially abusive tax shelter; and

3.2.8.3. Makes or provides any oral or written statement to any person about the potential tax consequences of that transaction.

3.2.8.4. The minimum fee is \$250,000 if the acquiring entities are corporations, other than S corporations. For all other transactions, the minimum fee is

\$50,000. When calculating the minimum fee, each transaction is evaluated separately to determine whether the minimum fee threshold is satisfied.

3.2.9. **"Noneconomic substance transaction"** means the disallowance of any loss, deduction or credit, or addition to income attributable to a determination that the transaction or arrangement lacks economic substance. A transaction lacks economic substance if the taxpayer cannot demonstrate a valid West Virginia business purpose other than tax savings.

3.2.10. **"Organizer"** means any person who discovers, creates, investigates, or initiates the tax shelter investment, devises the business or financial plans for the investment or carries out those plans through negotiations or transactions with others. This term also includes any other person who participates in the organization or management of the tax shelter.

3.2.11. **"Potentially abusive tax shelter"** means any tax shelter required to be registered under current federal law or is a reportable transaction under present federal law or West Virginia law.

3.2.12. **"Promoter"** means any person who, directly or indirectly, organizes or assists in the organization of a tax shelter or who participates in the sale of any interests in a shelter.

3.2.13. **"Related business entities"** and **"related parties"** are persons who bear a relationship to each other as described in I.R.C. § 267(b) or 707(b).

3.2.14. **"Reportable transaction"** means any transaction the Internal Revenue Service or this State determines as having a potential for tax avoidance or evasion, and includes the following transactions:

3.2.14.1. Listed transactions;

3.2.14.2. Confidential transactions;

3.2.14.3. Transactions with contractual protection;

3.2.14.4. Loss transactions;

3.2.14.5. Transactions with a significant book-tax difference: Provided, That significant book-tax difference transactions entered into on or after January 6, 2006 that do not also describe any other reportable transaction in Treasury Regulation Section 1.6011-4 will no longer be classified as reportable transactions: Provided, however, That this removal of significant book-tax difference transactions from the categories of reportable transactions does not relieve taxpayers, tax shelter organizers or material advisors of any disclosure, registration or list maintenance obligations for transactions that should have been disclosed or registered, or for

transactions for which lists should have been prepared and maintained, prior to January 6, 2006; and

3.2.14.6. Transactions involving a brief asset holding period.

3.2.15. "**Reportable transaction understatement**" means the product of:

3.2.15.1. The amount of the increase (if any) in taxable income, as determined by reference to the amount of post-apportioned income that results from a difference between the proper tax treatment of an item to which this paragraph applies and the taxpayer's treatment of that item as shown on the taxpayer's return, including an amended return filed prior to the date the taxpayer is first contacted by the Tax Commissioner regarding the examination of the return; and

3.2.15.2. The applicable tax rates.

3.2.16. "**Reporting shareholder**" means a United States shareholder (as defined in I.R.C. § 551(a)) in a foreign personal holding company (as defined in I.R.C. § 552), a United States shareholder (as defined in I.R.C. § 951(b)) in a controlled foreign corporation (as defined in I.R.C. § 957), or a 10 percent shareholder (by vote or value) of a qualified electing fund (as defined in I.R.C. § 1295).

3.2.17. "**Seller**" for purposes of the list maintenance requirement, is:

3.2.17.1. Any organizer, underwriter, broker, or dealer (or other similar person) who transfers any interest in a tax shelter;

3.2.17.2. Any agent who negotiates the transfer of any interest in a tax shelter for the tax shelter, an organizer, or other person described in the immediately preceding 3.2.13.1;

3.2.17.3. Any investor (not described in the immediately preceding 3.2.13) who transfers any interest in a tax shelter, or

3.2.17.4. Any other person who receives consideration in connection with another person's right to participate in a tax shelter, for services necessary to the organization or structure of such tax shelter (other than services that do not constitute participation in the organization or management of a tax shelter under Treasury Regulation Section 301.6111-1T), or for information that is integral to the participation in such tax shelter.

3.2.18. "**Substantially similar**" means and includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar shall be broadly construed in favor of disclosure.

3.2.19. **"Tax avoidance transaction"** means a plan or arrangement devised for the principal purpose of avoiding federal or state income tax or both. Tax avoidance transactions include, but are not limited to, "listed transactions" as defined and/or described in Treasury Regulations Section 1.6011-4(b)(2).

3.2.20. **"Tax benefit"** means and includes deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, status as an entity exempt from Federal income taxation, and any other tax consequences that may reduce a taxpayer's West Virginia income tax liability by affecting the amount, timing, character, or source of any item of income, gain, expense, loss, or credit.

3.2.21. **"Tax shelter"** means a tax avoidance transaction.

3.2.22. **"Tax structure"** means any fact that may be relevant to understanding the purported or claimed West Virginia Personal Income Tax treatment or West Virginia Corporation Net Income Tax treatment of the transaction.

3.2.23. **"Tax treatment"** means the tax treatment of a transaction that is the purported or claimed West Virginia Personal Income Tax treatment or West Virginia corporation Net Income Tax treatment of the transaction.

3.2.24. **"Transaction"** means and includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan.

3.2.25. **"Transactions involving a brief holding period"** means any transaction resulting in the taxpayer claiming a tax credit exceeding \$ 250,000 (including a foreign tax credit) if the underlying asset giving rise to the credit is held by the taxpayer for 45 days or less. For purposes of determining the holding period, the principles of I.R.C. § 246(c)(3) and (c)(4) apply. Transactions resulting in a foreign tax credit for withholding taxes or other taxes imposed in respect of a dividend that are not disallowed under I.R.C. § 901(k) (including transactions eligible for the exception for securities dealers under I.R.C. § 901(k)(4)) are excluded from this term.

3.2.26. **"Transaction with a significant book-tax difference"** means a transaction where the amount for tax purposes of any item or items of income, gain, expense, or loss from the transaction differs by more than \$ 10 million on a gross basis from the amount of the item or items for book purposes in any taxable year.

3.2.27. **"Transaction with contractual protection"** means a transaction for which the taxpayer or a related party (as described in I.R.C. § 267(b) or I.R.C. § 707(b)) has the right to a full or partial refund of fees if all or part of the intended tax consequences from the transaction are not sustained. A transaction with contractual

protection also is a transaction for which fees are contingent on the taxpayer's realization of tax benefits from the transaction.

#### **§110-10J-4. Reportable transactions.**

4.1. For each taxable year in which a taxpayer is required to make a disclosure statement under Treasury Regulations Section 1.6011-4 with respect to any reportable transaction in which the taxpayer participated in a taxable year for which a return is required, such taxpayer shall file a copy of such disclosure with the Tax Commissioner: Provided, That this disclosure requirement also applies to any taxpayer that is a member of a consolidated group that is required to make such a disclosure.

4.1.1. Disclosure under this subsection is required to be made by any taxpayer that is a member of a unitary business group that includes any person required to make a disclosure statement under Treasury Regulations Section 1.6011-4.

4.1.2. Disclosure under this subsection is required with respect to any reportable transaction entered into after February 28, 2000, that becomes a listed transaction at any time, and shall be made in the manner prescribed in this rule.

4.1.2.1. If a taxpayer fails to disclose a listed transaction on either the taxpayer's state or federal income tax return, an assessment may be made at any time not later than six years after the due date of the return required under West Virginia Code § 11-21-1 et seq., or West Virginia Code § 11-24-1 et seq., for the same taxable year or after such return was filed, or not later than three years after an amended return is filed, whichever is later.

4.1.3. With respect to reportable transactions in which the taxpayer participated for taxable years ending before December 31, 2004, disclosure shall be made by the due date of the first annual return due after June 8, 2006: Provided, That if the taxpayer has applied for and been granted an extension of time for filing the first annual return that is due after June 8, 2006, the extension of time shall apply in like manner to the disclosure statement required to be filed with the return.

4.1.4. With respect to reportable transactions in which the taxpayer participated for taxable years ending on and after December 31, 2004, disclosure shall be made in the time and manner prescribed in Treasury Regulations Section 1.6011-4(e).

4.1.4.1. The disclosure statement for a reportable transaction must be attached to the taxpayer's tax return for each taxable year for which a taxpayer participates in a reportable transaction. In addition, the disclosure statement for a reportable transaction must be attached to each amended return that reflects a taxpayer's participation in a reportable transaction. If a reportable transaction results in a loss which is carried back to a prior year, the disclosure statement for the reportable transaction must be attached to the taxpayer's application for tentative refund or



amended tax return for that prior year. In the case of a taxpayer that is a partnership or S corporation, the disclosure statement for a reportable transaction must be attached to the partnership's or S corporation's tax return for each taxable year in which the partnership or S corporation participates in the transaction under the rules of section 5 of this rule.

4.1.4.2. If a transaction becomes a listed transaction after the filing of a taxpayer's tax return (including an amended return) reflecting either tax consequences or a tax strategy described in guidance published by the Internal Revenue Service listing the transaction (or a tax benefit derived from tax consequences or a tax strategy described in the publication) and before the end of the period of limitations for the final return (whether or not already filed) reflecting the tax consequences, tax strategy, or tax benefit, then a disclosure statement must be filed as an attachment to the taxpayer's tax return next filed after the date the transaction is listed regardless of whether the taxpayer participated in the transaction in that year.

4.1.5. Notwithstanding the above, no disclosure is required for transactions entered into after the February 28, 2000 and before January 1, 2004:

4.1.5.1. If the taxpayer has filed an amended West Virginia income tax return which reverses the tax benefits of the potential tax avoidance transaction; or

4.1.5.2. As a result of a federal audit the Internal Revenue Service has determined the tax treatment of the transaction and a West Virginia amended return has been filed to reflect the federal treatment.

4.1.6. If as a result of filing a disclosure required by West Virginia Code § 11-10E-5 and this rule a taxpayer's tax liability for any taxable year for tax imposed by West Virginia Code § 11-21-1 et seq., or West Virginia Code § 11-24-1 et seq., the appropriate amended tax return or returns for the affected tax year or years are required to be filed.

4.1.7. Any action by the Internal Revenue Service resulting in a reportable transaction being added to, modified or removed from the categories of reportable transactions identified and described in Treasury Regulations Section 1.6011-4, or identified and described in any other Treasury publication, will be treated in like manner by the Tax Department and deemed to be incorporated herein.

**4.2. Reportable transaction understatement penalty.** -- If a taxpayer has a reportable transaction understatement for any taxable year, there shall be added to the tax an amount equal to 20% of the amount of that understatement. This penalty shall be deemed assessed upon the assessment of the tax to which such penalty relates and shall be collected and paid on notice and demand in the same manner as the tax.

4.2.1. This subsection 4.2 applies to any item which is attributable to either of the following:

4.2.1.1. Any listed transaction as defined in Treasury Regulations Section 1.6011-4 and section 3 of this rule; and

4.2.1.2. Any other reportable transaction as defined in Treasury Regulations Section 1.6011-4 and section 3 of this rule (other than a listed transaction) if a significant purpose of the transaction is the avoidance or evasion of federal income tax. The following additional information is provided relative to reportable transactions other than listed transactions so as to assist in determining whether certain transactions are deemed to be reportable transactions other than listed transactions.

**4.2.1.2.a. Confidential transactions.** - For confidential transactions, a transaction is considered to be offered to a taxpayer under conditions of confidentiality if the material advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that material advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the material advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction.

4.2.1.2.a.1. The minimum fee is:

4.2.1.2.a.1.A. \$ 250,000 for a transaction if the taxpayer is a corporation; or,

4.2.1.2.a.1.B. \$ 50,000 for all other transactions unless the taxpayer is a partnership or trust, all of the owners or beneficiaries of which are corporations (looking through any partners or beneficiaries that are themselves partnerships or trusts), in which case the minimum fee is \$ 250,000.

4.2.1.2.a.2. A minimum fee includes all fees for a tax strategy, for services for advice (whether or not tax advice), or for the implementation of a transaction. These fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent that the fees exceed the fees customary for return preparation. A taxpayer is treated as paying fees to a material advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the material advisor, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including a material advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property.

#### **4.2.1.2.b. Transactions with contractual protections. –**

When determining whether the transaction has contractual protections, all the facts and circumstances relating to the transaction will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to the transaction have not designated as fees or any agreement to provide services without reasonable compensation.

4.2.1.2.b.1. Fees are required to have been paid by or on behalf of the taxpayer or a related party to any person who makes or provides a statement, oral or written, to the taxpayer or related party (or for whose benefit a statement is made or provided to the taxpayer or related party) as to the potential tax consequences that may result from the transaction.

#### **4.2.1.2.b.2. Exceptions**

4.2.1.2.b.2.A. Termination of transaction. A transaction is not considered to have contractual protection solely because a party to the transaction has the right to terminate the transaction upon the happening of an event affecting the taxation of one or more parties to the transaction.

4.2.1.2.b.2.B. Previously reported transaction. If a person makes or provides a statement to a taxpayer as to the potential tax consequences that may result from a transaction only after the taxpayer has entered into the transaction and reported the consequences of the transaction on a filed tax return, and the person has not previously received fees from the taxpayer relating to the transaction, then any refundable or contingent fees are not taken into account in determining whether the transaction has contractual protection.

4.2.1.2.c. **Loss transactions.** - In determining whether a transaction results in a taxpayer claiming a loss that meets the threshold amounts over a combination of taxable years, only losses claimed in the taxable year that the transaction is entered into and the five succeeding taxable years are combined.

4.2.1.2.c.1. Because a loss transaction is a transaction resulting in a loss being claimed under I.R.C. § 165, for purposes of loss transactions, an I.R.C. § 165 loss includes the following:

4.2.1.2.c.1.A. When determining the thresholds as stated in the definition of "loss transaction in section 2 of this rule, the amount of an I.R.C. § 165 loss is adjusted for any salvage value and for any insurance or other compensation received. However, an I.R.C. § 165 loss does not take into account offsetting gains, or other income or limitations. The full amount of an I.R.C. § 165 loss is taken into account for the year in which the loss is sustained, regardless of whether all or part of the loss enters into the computation of a net operating loss under I.R.C. § 172 or a net capital loss under I.R.C. § 1212 that is a carryback or carryover to another year. An I.R.C. § 165 loss does not include any portion of a loss, attributable to a capital

loss carryback or carryover from another year, that is treated as a deemed capital loss under I.R.C. § 1212.

4.2.1.2.c.1.B. An I.R.C. § 165 loss includes an amount deductible pursuant to a provision that treats a transaction as a sale or other disposition, or otherwise results in a deduction under I.R.C. § 165. An I.R.C. § 165 loss includes, for example, a loss resulting from a sale or exchange of a partnership interest under I.R.C. § 741 and a loss resulting from an I.R.C. § 988 transaction.

**4.2.1.2.d. Transactions with a significant book-tax difference.** – For purposes of determining whether the transaction is a transactions with a significant book-tax difference, offsetting items may not be netted for either tax or book purposes. The amount of an item for book purposes is determined by applying United States generally accepted accounting principles (U.S. GAAP) for worldwide income. However, if a taxpayer, in the ordinary course of its business, keeps books for reporting financial results to shareholders, creditors, or regulators on a basis other than U.S. GAAP, and does not maintain U.S. GAAP books for any purpose, then the taxpayer may determine the amount of a book item by using the books maintained by the taxpayer, provided the books are kept on the same basis consistently from year to year. Adjustments to any reserve for taxes are disregarded for purposes of determining the book-tax difference.

4.2.1.2.d.1. In general, this category of reportable transactions applies only to:

4.2.1.2.d.1.A. (1) Taxpayers that are reporting companies under the Securities Exchange Act of 1934 and are related business; or

4.2.1.2.d.1.B. Business entities that have \$ 250 million or more in gross assets for book purposes at the end of any financial accounting period that ends with or within the entity's taxable year in which the transaction occurs (for purposes of this determination, the assets of all related business entities) must be aggregated.

4.2.1.2.d.2. Consolidated returns. For purposes of this category of reportable transactions, in the case of taxpayers that are members of a group of affiliated corporations filing a consolidated return, transactions solely between or among members of the group will not be disregarded. Moreover, where two or more members of the group participate in a transaction that is not solely between or among members of the group, items shall be aggregated (as if such members were a single taxpayer), but any offsetting items shall not be netted.

4.2.1.2.d.3. Foreign persons. In the case of a taxpayer that is a foreign person (other than a foreign corporation that is treated as a domestic corporation for Federal tax purposes under I.R.C. § 269B, 953(d), 1504(d) or any other provision of the Internal Revenue Code), only assets that are U.S. assets under Treasury Regulation § 1.884-1(d) shall be taken into account for purposes of part 4.2.1.2.d.2 of this rule, and only transactions that give rise to income that is effectively connected with the conduct of a trade or business within the United States (or to losses,

expenses, or deductions allocated or apportioned to such income) shall be taken into account for purposes of this reportable transaction.

4.2.1.2.d.4. Owners of disregarded entities. In the case of an eligible entity that is disregarded as an entity separate from its owner for Federal tax purposes, items of income, gain, loss, or expense that otherwise are considered items of the entity for book purposes shall be treated as items of its owner, and items arising from transactions between the entity and its owner shall be disregarded, for purposes of this reportable transaction.

4.2.1.2.d.5. Partners of partnerships. In the case of a taxpayer that is a member or a partner of an entity that is treated as a partnership for Federal tax purposes, items of income, gain, loss, or expense that are allocable to the taxpayer for Federal tax purposes, but otherwise are considered items of the entity for book purposes, shall be treated as items of the taxpayer for purposes of this reportable transaction.

#### **§ 110-10J-5. Participation in a reportable transaction.**

5.1. A taxpayer is required by West Virginia Code § 11-10E-5 to file each year a disclosure statement with respect to each reportable transaction in which the taxpayer participated.

5.2. The following applies to determining whether a taxpayer participated in a reportable transaction.

5.2.1. **Listed transactions.** A taxpayer has participated in a listed transaction if the taxpayer's tax return reflects tax consequences or a tax strategy described in the published guidance that lists the transaction under Treasury Regulations Section 1.6011-4(b)(2). A taxpayer also has participated in a listed transaction if the taxpayer knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from tax consequences or a tax strategy described in published guidance that lists a transaction described Treasury Regulations Section 1.6011-4(b)(2). Published guidance may identify other types or classes of persons that will be treated as participants in a listed transaction.

5.2.2. **Confidential transactions.** A taxpayer has participated in a confidential transaction if the taxpayer's tax return reflects a tax benefit from the transaction and the taxpayer's disclosure of the tax treatment or tax structure of the transaction is limited in the manner described in Treasury Regulations Section 1.6011-4(b)(3). If a partnership's, S corporation's or trust's disclosure is limited, and the partner's, shareholder's, or beneficiary's disclosure is not limited, then the partnership, S corporation, or trust, and not the partner, shareholder, or beneficiary, has participated in the confidential transaction.

5.2.3. **Transactions with contractual protection.** A taxpayer has participated in a transaction with contractual protection if the taxpayer's tax return reflects a tax benefit from the transaction and, as described in Treasury Regulations

Section 1.6011-4(b)(4), the taxpayer has the right to the full or partial refund of fees or the fees are contingent. If a partnership, S corporation, or trust has the right to a full or partial refund of fees or has a contingent fee arrangement, and the partner, shareholder, or beneficiary does not individually have the right to the refund of fees or a contingent fee arrangement, then the partnership, S corporation, or trust, and not the partner, shareholder, or beneficiary, has participated in the transaction with contractual protection.

**5.2.4. Loss transactions.** A taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a I.R.C. § 165 loss and the amount of the I.R.C. § 165 loss equals or exceeds the threshold amount applicable to the taxpayer as described in Treasury Regulations Section 1.6011-4(b)(5)(i). If a taxpayer is a partner in a partnership, shareholder in an S corporation, or beneficiary of a trust and a I.R.C. § 165 loss as described in Treasury Regulations Section 1.6011-4(b)(5) flows through the entity to the taxpayer (disregarding netting at the entity level), the taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a I.R.C. § 165 loss and the amount of the I.R.C. § 165 loss that flows through to the taxpayer equals or exceeds the threshold amounts applicable to the taxpayer as described in Treasury Regulations Section 1.6011-4(b)(5)(i). For this purpose, a tax return is deemed to reflect the full amount of a I.R.C. § 165 loss described in Treasury Regulations Section 1.6011-4(b)(5) allocable to the taxpayer under this subdivision 5.2.4, regardless of whether all or part of the loss enters into the computation of a net operating loss under I.R.C. § 172 or net capital loss under I.R.C. § 1212 that the taxpayer may carry back or carry over to another year.

**5.2.5. Transactions with a significant book-tax difference.** A taxpayer has participated in a transaction with a significant book-tax difference if the taxpayer's tax treatment of an item from the transaction differs from the book treatment of that item as described in Treasury Regulations Section 1.6011-4(b)(6). In determining whether a transaction results in a significant book-tax difference for a taxpayer, differences that arise solely because a subsidiary of the taxpayer is consolidated with the taxpayer, in whole or in part, for book purposes, but not for tax purposes, are not taken into account.

**5.2.6. Transactions involving a brief asset holding period.** A taxpayer has participated in a transaction involving a brief asset holding period if the taxpayer's tax return reflects items giving rise to a tax credit described in Treasury Regulations Section 1.6011-4(b)(7). If a taxpayer is a partner in a partnership, shareholder in an S corporation, or beneficiary of a trust and the items giving rise to a tax credit described in Treasury Regulations Section 1.6011-4(b)(7) flow through the entity to the taxpayer (disregarding netting at the entity level), the taxpayer has participated in a transaction involving a brief asset holding period if the taxpayer's tax return reflects the tax credit and the amount of the tax credit claimed by the taxpayer exceeds \$ 250,000.

**5.2.7. Shareholders of foreign corporations.** -- In general. A reporting shareholder of a foreign corporation participates in a transaction described in Treasury Regulations Section 1.6011-4(b)(2) through (5) and (b)(7) if the foreign corporation would be considered to participate in the transaction under the rules of Treasury Regulations Section 1.6011-4(c)(3) if it were a domestic corporation filing a tax return

that reflects the items from the transaction. A reporting shareholder participates in a transaction described in Treasury Regulations Section 1.6011-4(b)(6) only if the foreign corporation would be considered to participate in the transaction under the rules of Treasury Regulations Section 1.6011-4(c)(3) if it were a domestic corporation and the transaction reduces or eliminates an income inclusion that otherwise would be required under I.R.C. § 551, 951, or 1293. A reporting shareholder (and any successor in interest) is considered to participate in a transaction under Treasury Regulations Section 1.6011-4(c)(3)(i)(G) only for its first taxable year with or within which ends the first taxable year of the foreign corporation in which the foreign corporation participates in the transaction, and for the reporting shareholder's five succeeding taxable years.

#### **§110-10J-6. Registration of tax shelters.**

6.1. Any tax shelter organizer required to register a tax shelter under I.R.C. § 6111 prior to its amendment on October 22, 2004, and any material advisor required under I.R.C. § 6111 after its amendment on October 22, 2004 to register a reportable transaction or listed transaction shall send a duplicate of the federal registration information to the Tax Commissioner not later than the day on which registration is required under federal law. Any person required to register under I.R.C. § 6111 who receives a tax registration number from the Secretary of the Treasury shall, within thirty days after request by the Tax Commissioner, file a statement of that registration number with the Tax Commissioner.

6.2. In addition to the requirements of subsection 6.1 of this rule, any transactions entered into on or after February 28, 2000, that become listed transactions at any time, shall be registered with the Tax Commissioner by the later of:

6.2.1. Sixty days after entering into the transaction;

6.2.2. Sixty days after the transaction becomes a listed transaction; or

6.2.3. The first day of July, two thousand six.

6.3. The provisions of this section apply to any tax shelter herein described in which a person:

6.3.1. Organizes or participates in the sale of an interest in a partnership, entity or other plan or arrangement; and

6.3.2. Makes or causes another person to make a false or fraudulent statement with respect to securing a tax benefit or a gross valuation as to any material matter, and which is or was one or more of the following:

6.3.2.1. Organized in this state;

6.3.2.2. Doing business in this state; or

6.3.2.3. Deriving income from sources in this state.

6.4. Any person required to file a return under West Virginia Code § 11-10E-1 et seq., and this rule and required to include on the person's federal income tax return a tax shelter identification number pursuant to I.R.C. § 6111 shall furnish such number when filing the person's West Virginia return.

**§101-10J-7. Investor lists.**

7.1. Any person required to maintain a list under I.R.C. § 6112 and Treasury Regulations Section 301.6112-1 with respect to a potentially abusive tax shelter shall furnish such list to the Tax Commissioner not later than the time such list is required to be furnished to the Internal Revenue Service under federal income tax law. The list required under this section shall include the same information required with respect to a potentially abusive tax shelter under Treasury Regulations Section 301.6112-1 and any other information that the Tax Commissioner may require.

7.2. For transactions entered into on or after February 28, 2000, that becomes listed transactions at any time thereafter, the list shall be furnished to the Tax Commissioner by the later of:

7.2.1. Sixty days after entering into the transaction; or

7.2.2. Sixty days after the transaction becomes a listed transaction.

7.3. The provisions of this section apply to any tax shelter herein described in which a person:

7.3.1. Organizes or participates in the sale of an interest in a partnership, entity or other plan or arrangement; and

7.3.2. Makes or causes another person to make a false or fraudulent statement with respect to securing a tax benefit or a gross valuation as to any material matter; and

7.3.3. Which is or was one or more of the following:

7.3.3.1. Organized in this state;

7.3.3.2. Doing business in this state; or

7.3.3.3. Deriving income from sources in this state.

**§110-10J-8. Penalties.**

8.1. Promoting tax shelters.



8.1.1. Any person:

8.1.1.1. Who organizes (or assists in the organization) of a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, or

8.1.1.2. Who participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement referred to in paragraph 8.1.1.1 of this rule, and

8.1.1.3. Who makes or furnishes or causes another person to make or furnish (in connection with such organization or sale) 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 does not know or does not have reason to know is false or fraudulent as to any material matter, or is a gross valuation overstatement as to any material matter, shall pay, with respect to each activity described in paragraph 8.1.1.1, a penalty equal to the \$ 1,000 or, if the person establishes that it is lesser, 100% of the gross income derived (or to be derived) by such person from such activity.

8.1.1.4. For purposes of the preceding sentence, the activities described paragraph 8.1.1.1 with respect to each entity or arrangement shall be treated as a separate activity and participation in each sale described in paragraph 8.1.1.2 shall be so treated.

8.1.2. Any person:

8.1.2.1. Who organizes (or assists in the organization) of a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, or

8.1.2.2. Who participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement referred to in paragraph 8.1.2.1 of this rule, and

8.1.2.3. Who makes or furnishes or causes another person to make or furnish (in connection with such organization or sale) 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 a gross valuation overstatement as to any material matter, shall pay, with respect to each activity described in paragraph 8.1.2.1, a penalty equal to the \$ 1,000 or, if the person establishes that it is lesser, 100% of the gross income derived (or to be derived) by such person from such activity.

8.1.2.4. For purposes of the preceding paragraph, the activities described paragraph 8.1.1.1 with respect to each entity or arrangement shall be treated as a separate activity and participation in each sale described in paragraph 8.1.2.2 shall also be so treated.

8.1.2.5. Notwithstanding the foregoing, if an activity with respect to which a penalty imposed under this subsection involves a statement described in paragraph 8.1.2.3, the amount of the penalty shall be equal to 50% of the gross income derived (or to be derived) from such activity by the person on which the penalty is imposed.

8.1.3. The Tax Commissioner may waive all or any part of the penalty provided by subdivision 8.1.1 or 8.1.2 of this rule 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.

8.1.4. The penalty imposed by this subsection shall be in addition to any other penalty provided by law.

## **8.2. Failure to register tax shelter or maintain list.**

8.2.1. **Penalty imposed.** -- Any person that fails to comply with the requirements of West Virginia Code § 11-10E-8 or West Virginia Code § 11-10E-9 shall incur a penalty as provided in subdivision 8.2.2 of this rule. A person is not in compliance with the requirements of West Virginia Code § 11-10E-8 unless and until the required registration has been filed and contains all of the information required to be included with such registration under West Virginia Code § 11-10E-8 or I.R.C. § 6111: Provided, That a person will be deemed to be in compliance with West Virginia Code § 11-10E-8 if that person has filed with the Tax commissioner all information required to be filed with the Internal Revenue Service. A person shall not be in compliance with the requirements of West Virginia Code § 11-10E-9 unless, at the time the required list is made available to the Tax Commissioner, such list contains all of the information required to be maintained under West Virginia Code § 11-10E-9 or I.R.C. § 6112.

8.2.2. **Amount of penalty.** -- The following penalties apply:

8.2.2.1. In the case of each failure to comply with the requirements of West Virginia Code § 11-10E-8 (a), (b) or (d), the penalty shall be \$10,000;

8.2.2.2. If the failure to comply with the requirements of West Virginia Code § 11-10E-8 (a), (b) or (d) is with respect to a listed transaction described in West Virginia Code § 11-10E-8(c), the penalty shall be \$100,000;

8.2.2.3. In the case of each failure to comply with the requirements of West Virginia Code § 11-10E-9(a) or (b), the penalty shall be \$10,000; and

8.2.2.4. If the failure to comply with the requirements of West Virginia Code § 11-10E-9(a) or (b) is with respect to a listed transaction described in West Virginia Code § 11-10E-9(c), the penalty shall be \$100,000.

8.2.3. **Authority to rescind penalty.** -- The Office of Tax Appeals, with the written approval of the Tax Commissioner, may rescind all or any portion of any

penalty imposed by West Virginia Code § 11-10E-6 with respect to any violation only if one or more of the following apply:

8.2.3.1. It is determined that failure to comply did not jeopardize the best interests of the state and is not due to any willful neglect or any intent not to comply;

8.2.3.2. It is shown that the violation is due to an unintentional mistake of fact;

8.2.3.3. Rescinding the penalty would promote compliance with the requirements of West Virginia Code § 11-10E-1 et seq., and effective tax administration; or

8.2.3.4. The taxpayer can show that there was reasonable cause for the failure to disclose and that the taxpayer acted in good faith.

**8.2.4. Coordination with other penalties.** -- The penalty imposed by West Virginia Code § 11-10E-6 is in addition to any other penalty imposed by West Virginia Code § 11-10E-1 et seq., or West Virginia Code § 11-10- et seq.

**8.3. Reportable transaction understatement penalty.** -- If a taxpayer has a reportable transaction understatement for any taxable year, there shall be added to the tax an amount equal to 20% of the amount of that understatement. This penalty shall be deemed assessed upon the assessment of the tax to which such penalty relates and shall be collected and paid on notice and demand in the same manner as the tax.

8.3.1. This subsection 8.3 applies to any item which is attributable to either of the following:

8.3.1.1. Any listed transaction as defined in Treasury Regulations Section 1.6011-4 and section 3 of this rule; and

8.3.1.2. Any other reportable transaction as defined in Treasury Regulations Section 1.6011-4 and section 3 of this rule (other than a listed transaction) if a significant purpose of the transaction is the avoidance or evasion of federal income tax.

8.3.2. Failure to comply with this subsection 8.3 will result in the reportable transaction understatement penalty being increased to 30% of the amount of that understatement.

**8.3.3. Reasonable cause exception.** -- No penalty shall be imposed under this subsection with respect to any portion of a reportable transaction understatement if it is shown by clear and convincing evidence that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion. Reasonable cause for failure to adequately disclose is to be demonstrated by the taxpayer satisfying all of the following:

8.3.3.1. If the penalty for that failure was rescinded;

8.3.3.2. There is or was substantial authority for such treatment;

and

8.3.3.3. The taxpayer reasonably believed that such treatment was more likely than not the proper treatment.

#### **8.4. Promoting tax shelters.**

8.4.1. The provisions of I.R.C. § 6700 apply for purposes of West Virginia Code § 11-10E-1 et seq., as if such section applied to a West Virginia deduction, credit, exclusion from income, allocation or apportionment rule, or other West Virginia tax benefit: Provided, That if an activity with respect to which a penalty imposed under I.R.C. § 6700(a), as applied for purposes of West Virginia Code § 11-10E-1 et seq., involves a false or fraudulent statement as described in I.R.C. § 6700(a)(2)(A), the amount of the penalty shall be 50% fifty percent of the gross income derived (or to be derived) from such activity by the person upon which the penalty is imposed.

#### **8.5. Failure to disclose listed transactions.**

8.5.1. For audits of returns commencing on or after July 1, 2006, when it appears that any part of the deficiency for which an assessment is made is due to failure to disclose a listed transaction or a reportable transaction other than a listed transaction, as the terms are defined in I.R.C. § 6707A, or any subsequent corresponding provision of the Internal Revenue Code as from time to time amended, on the taxpayer's federal income tax return, there shall be imposed a penalty:

8.5.1.1. In the case of a listed transaction the amount of the penalty shall be equal to 70% of the amount of the deficiency; and

8.5.1.2. In the case of other reportable transactions the amount of the penalty shall be equal to 35% of the amount of the deficiency.