DEPARTMENT OF THE TREASURY
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MEMORANDUM FOR ROLAND BARRAL, CC:LM:FSH
AREA COUNSEL

FROM: Donna M. Young, CC:PSI:3
Acting Branch Chief

SUBJECT: Application of the § 6707 penalty.

This responds to your inquiry and our discussions regarding the § 6707 penalty consequences for a promoter's failure to register a tax shelter under § 6111.[1] You have determined that the investment in question is a tax shelter within the meaning of § 6111(c) and that the promoter likely did not register the shelter as required by § 6111(a). This memorandum addresses some of the general issues that have been raised. This memorandum constitutes Chief Counsel Advice. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

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[1] All references to the Code or regulations in this memorandum are to the Code and regulations as in effect for the years involved in these transactions. Nothing in this memorandum relates in any manner to the new tax shelter regulations issued February 28, 2000.

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ISSUES

1. Is there a statute of limitations for assessing the penalty under § 6707(a)(1) for failure to register a tax shelter?

2. If the Service obtained details of the shelter and promotion activity through prior administrative actions against the promoter, could the § 6707 penalty now be avoided through a theory of substantial compliance or laches?

3. How is the penalty under § 6707 calculated?

4. What procedural rights exist to contest a penalty assessed under § 6707(a)(1)?

CONCLUSIONS

1. There is no statute of limitations for assessing the penalty under § 6707(a)(1) for a failure to register a tax shelter.

2. The fact that the Service obtained information regarding the shelter and promotion activity through prior proceedings against the promoter does not absolve the promoter's obligations under § 6111. In this case, there was neither actual nor substantial compliance by the taxpayer. Furthermore, the government has not unreasonably or unfairly delayed the application of the § 6707 penalty in this case, and in any event, the equitable doctrine of laches is inapplicable to the government. Therefore the relevant issue is whether the promoter properly registered the shelter, not the length of time the Service takes to assert the penalty.

3. The penalty under § 6707 in this case is based on 1 percent of the aggregate amount invested in the shelter.

4. If a penalty is assessed under § 6707, the taxpayer will have an opportunity to request abatement at administrative levels. If the taxpayer wishes to litigate the issue, the taxpayer must pay the penalty and institute refund proceedings.

LAW AND ANALYSIS

Section 6111 requires certain specially identified tax shelters to register. The term "tax shelter" is defined by § 6111(c)(1) to include any investment (1) with respect to which any person could reasonably infer from the representations made (or to be made) in connection with the offering for sale of interests in the investment that the tax shelter ratio for any investor as of the close of any of the first 5 years ending after the date on which such investment is offered for sale may be greater than 2 to 1, and (2) which is a substantial investment. The tax shelter ratio means, with respect to any year, the ratio which (A) the aggregate amount of the deductions and 350 percent of the credits which are represented to be potentially allowable to any investor under subtitle A for all periods up to (and including) the close of such year, bears to the (B) the investment base as of the close of such year. Section 6111(c)(2).

If an investment qualifies as a tax shelter under § 6111(c), its organizer must register the tax shelter not later than the day on which the first offering for sale of interests in the shelter occurs. Section 6111(a). For these purposes, the term "tax shelter organizer" means the person principally responsible for organizing the tax shelter. Section 6111(e)(1). If the person principally responsible for organizing the tax shelter fails to timely register the shelter, the obligation falls to any other person who participated in the organization of the tax shelter. Section 6111(e)(1)(B). Finally, if none of the organizers timely register a tax shelter, any person participating in the sale or management of the shelter at a time when the shelter should have been registered. Section 6111(e)(1)(C).

Section 6707(a)(1) imposes a penalty on a person who is required to register a tax shelter under § 6111(a) but fails to do so (or files false or incomplete information). Section 6707(a)(2) indicates that the penalty under paragraph (a)(1) is equal to the greater of 1 percent of the aggregate amount invested in the tax shelter, or $500.

1. The penalty under § 6707(a)(1) may be assessed at any time without regard to § 6501(a) or other statutes of limitations outside the Internal Revenue Code.

There is no specific Code provision providing a statute of limitations for the assessment of § 6707 penalties. However, § 6707 is part of subchapter 68B of the Code and § 6671 provides that subchapter 68B penalties and liabilities are assessed and collected in the same manner as taxes.

Section 6501 provides the generally applicable statute of limitations for assessing taxes. The § 6501 limitations period is 3 years from when the return was filed. If no return was filed, or a false or fraudulent return was filed, the tax may be assessed at any time.

As explained below, the rules of § 6501 apply to return-based liabilities, i.e., tax liabilities or other liabilities required to be shown on a tax return or related to or based on a return. If a penalty is not a return-based penalty, the Service may assess the penalty at any time. Neither § 6501 nor any other statute of limitations applies in such a case.

The Service has successfully argued that no statute of limitations applies to the promoter penalties under §§ 6700 and 6701 and thus these penalties may be assessed at any time. The courts have rejected both the application of § 6501 and another statute of limitations not found in the Internal Revenue Code (28 U.S.C. § 2462). See Mullikin v. U.S., 952 F.2d 920 (6th Cir. 1991); Lamb v. U.S., 977 F.2d 1296 (8th. Cir. 1992); Capozzi v. U.S., 980 F.2d 872 (2d Cir. 1992); and Sage v. U.S., 908 F.2d 18 (5th Cir. 1990).

By contrast, the Service was not successful in arguing that no statute of limitations applies to the § 6672 trust fund recovery penalty, which is imposed on corporate officers and other "responsible persons" if withheld employment taxes are not paid by the employer to the government. Lauckner v. United States, 68 F.3d 69 (3d Cir. 1995), aff'g No. 93-1594 (D.N.J. 1994), acq., A.O.D. 1996-006, 1996-2 C.B. 1.

In Lauckner, the Service argued that § 6501 does not apply because the § 6672 penalty is not reported on any return by the corporate officer or other responsible person against whom the penalty is assessed but, instead, is triggered by conduct of the responsible person, which is not reported on any return. The district court and the court of appeals rejected this argument and concluded that § 6501 applies to this penalty because the penalty does not create a liability that is "separate and distinct" from the underlying employment tax liability. In other words, the penalty imposed on the responsible person is simply an enforcement mechanism for collecting the employment tax liability imposed on the employer. The penalty is therefore "based on" the employment tax return and thus the filing of

the return triggers the running of the statute of limitations applicable to the penalty. (An additional reason for rejecting the Service's litigating position was that for many years the Service had maintained a contrary administrative position, i.e., that § 6501 did apply to the penalty. It was improper for the Service to change its long-held position without first announcing the change by publishing a revenue ruling or other document and providing an explanation.)

Based on this case law, we conclude that the § 6707(a)(1) penalty is not a return-based penalty. First, we note that the Form 8264 used for registration of a tax shelter is not a tax return because the Form does not show or declare any liability. Second, although the Form 8264 supplies information to the Service, it is not an information return as defined in § 6724(d).[2] Third, the Form 8264 is not attached to or otherwise related to any tax return of the tax shelter promoter or organizer. Fourth, the present issue is easily distinguishable from Lauckner. Although in both situations the penalty is triggered by a failure to perform a required act, the situations differ in that the § 6707(a)(1) penalty is truly separate and distinct from any liability of the tax shelter organizer or other person. Also, unlike the situation in Lauckner, the Service would not be reversing a prior long-held administrative position in reaching an adverse conclusion on this issue.

Thus, we conclude that neither § 6501 nor any other statute of limitations applies to the assessment of this penalty. The Service may assess the penalty at any time without regard to when interests in the shelter were sold. This is true both if no Form 8264 was filed or if a misleading, incomplete, false, or fraudulent Form 8264 was filed.

As a caveat, prior IRM 42(17)(12).13 explicitly stated that penalty assessments under § 6707 will not have a statute of limitations "in every case." This indicates that there may be some cases in which a statute of limitations would apply. As stated above, we believe that a statute of limitations never applies to a penalty asserted under § 6707(a)(1). Section 6707(b)(2), however, provides for a minor penalty for the failure to include a tax shelter identification number on a return. We do not opine on whether the penalty under § 6707(b)(2) is subject to a statute of limitations.

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[2]We recognize that a taxpayer could attempt to analogize a Form 8264 to an information return for purposes of invoking the three year statute of § 6501(a). However, we would not expect such an argument in your case due to the unlimited statute of limitations under § 6501(c)(3) for the failure to file a return.

2. The § 6707 penalty cannot be avoided through a theory of substantial compliance or laches, despite the Service's awareness of the shelter and the promotion activity.

As has been discussed, there is no statute of limitations on the assessment of penalties under § 6707(a)(1) for a failure to register a tax shelter under § 6111. In the present case, the Service has had knowledge of the shelter, the promoter's activity, and the identity of the investors through prior proceedings. Because the Service obtained information regarding the shelter and the promotional activity through prior proceedings against the promoter and various investors, it is possible that the promoter may attempt to assert that it has substantially complied with the requirements of § 6111. That is, because the Service obtained the relevant information from the promoter in another manner, the promoter should be treated as substantially complying with § 6111. Such an argument could potentially have merit if the promoter had attempted to comply with § 6111, but failed to satisfy all of the technical requirements. However, in the present case, the shelter was not registered, and the Service was forced to obtain its present knowledge through burdensome administrative and judicial proceedings. Under such circumstances, the promoter should not be considered to have substantially complied with the requirements of § 6111.

Section 6111 was intended to establish a mechanism through which the Service could easily identify tax shelters and those who invest in tax shelters. Therefore, the fact that the promoter may have provided information to the Service in the course of its prior proceedings should not constitute substantial compliance with § 6111 when the information was obtained in the type of proceedings that § 6111 was intended to bypass. It is well established that there is no defense of substantial compliance for failure to comply with the essential requirements of the governing statute. See Prussner v. U.S., 896 F.2d 218, 224 (7th Cir. 1990); See also Tipps v. Commissioner, 74 T.C. 458, 468 (1980); Penn-Dixie Steel Corp. v. Commissioner, 69 T.C. 837, 846 (1978); Rockwell Inn, Ltd. v. Commissioner, T.C. Memo. 1993-158. Moreover, substantial compliance cannot be applied if to do so would defeat the policies of the underlying statutory provisions. See Sawyer v. County of Sonoma, 719 F.2d 1001, 1008 (9th Cir. 1983). In the present case, the promoter's actions did not comply with the essential elements of the statute that were intended to enable the Service to easily identify the shelter and the investors.

Although the promoter will not be able to claim substantial compliance as a defense to the application of the penalties under § 6707, there is an additional issue about whether the Service's delay in asserting the penalty could give rise to the equitable defense of laches. The doctrine of laches is an equitable principle that bars recovery in circumstances in which a plaintiff's delay in seeking a judicial

remedy prejudices a defendant. To prevail, a party invoking this equitable principle "must show that plaintiffs unreasonably delayed in bringing suit and that [defendants] were prejudiced by this delay; the mere lapse of time does not constitute laches." Environmental Defense Fund v. Tennessee Valley Auth., 468 F.2d 1164, 1182 (6th Cir. 1972).

As a fundamental matter, it is widely recognized that laches will not bar a claim by the government. See U.S. v. Kirkpatrick, 22 U.S. (9 Wheat.) 720, 735, (1824) (Story, J.) ("The government can transact its business only through its agents; and its fiscal operations are so various, and its agencies so numerous and scattered, that the utmost vigilance would not save the public from the most serious losses, if the doctrine of laches can be applied to its transactions."). This fundamental recognition applies to tax matters as well. Simply put, laches is not a defense to the enforcement of tax claims by the United States. See U.S. v. Summerlin, 310 U.S. 414 (1940); see also Olshausen v. Commissioner, 273 F.2d 23, 28 (9th Cir. 1959), cert. denied, 363 U.S. 820 (1960). Despite this historic, and continuing, line of cases, the issue is relevant due to a recent Fifth Circuit case addressing the § 6700 penalty. While the court in that case held that there was no statute of limitations for the § 6700 penalty, it also stated, "Our holding today doubtless falls athwart the fond hopes of many a taxpayer and it is, perhaps, cold comfort to note that the doctrine of laches does remain -- the only curb on IRS penalty-assessment power under Section 6700." Sage v. U.S., 908 F.2d 18, 24 (5th Cir. 1990).

We do not believe that the Sage case represents a departure from the traditional view that laches will not bar a claim by the government. Other Circuits have continued to explicitly hold that laches will not bar an action by the Service. See Dial v. Commissioner, 968 F.2d 898, 904 (9th Cir. 1992); see also Taylor v. Commissioner (unreported) 95-1 U.S. Tax Cas. (CCH) P50,042; 75 A.F.T.R.2d (RIA) 525 (10th Cir. 1994); but see U.S. v. Administrative Enterprises, 46 F.3d 670 (7th. Cir. 1995) (The court does not find laches, but expresses the view that laches could bar certain types of government actions). It is significant that even within the Firth Circuit, the Sage language is recognized as dicta at odds with established precedent. See Marre and Agritech Enterprises, Inc. v. U.S., 98-1 U.S. Tax Cas. (CCH) P50,321; 81 A.F.T.R.2d (RIA) 1414 (S.D. of Tex, 1998). Additionally, a subsequent Fifth Circuit case expressed the more traditional view that laches may not be asserted against the United States when it is acting in its sovereign capacity to enforce a public right or protect the public interest. See In re Fein 22 F. 3d 631, 634 (5th Cir. 1994)

Further, we note that the Service has not been unreasonably slow in asserting this penalty. The cases arising from this shelter all involved partnership

audit proceedings, which for the years involved postponed consideration of penalties on the partners until the end of the proceedings. Thus, the Service reasonably did not turn its full attention to penalties until after resolution of the partnership proceedings. Also, all the parties and the promoter were made aware that the Service planned to impose penalties after completion of the partnership proceedings.

3. **What constitutes the "aggregate amount invested" for purposes of § 6707(a)(2)?**

Section 6707(a)(2) indicates that the penalty imposed for failure to comply with the registration requirements is the greater of 1 percent of the aggregate amount invested in the shelter, or $500.[3] From the plain language of the statute, it is clear that the penalty is based on the aggregate amount invested in the tax shelter, which may have very little relation to amounts received by the party subject to the penalty. Temp. Treas. Reg. § 1.6707-1T, Q&A-1 specifies that for purposes of the penalty, the aggregate amount invested in the tax shelter is computed in the manner prescribed in Temp. Treas. Reg. § 301.6111-1T, A-21. Thus, the "aggregate amount invested" is equivalent to the aggregate investment used for determining if a tax shelter investment is a substantial investment under § 6111(c)(4).

Temp. Treas. Reg. § 301.6111-1T, Q&A-21, specifies that the aggregate amount offered for sale is the aggregate amount to be received from the sale of interests in the investment and includes all cash, the fair market value of all property contributed, and the principal amount of all indebtedness received in exchange for interest in the investment, regardless of whether the proceeds of the indebtedness are included in the investment base. It is important to note that the aggregate amount invested for purposes of § 6707(a)(2) may exceed the "investment base" under § 6111(c)(3). It is also important to note that an interest in a tax shelter is defined broadly. See Temp. Treas. Reg. § 301.6111-1T, Q&A-42, and Temp. Treas. Reg. § 301.6112-1T, Q&A-7. Thus, the aggregate amount invested for purposes of § 6707(a)(2) (as well as § 6111(c)(4)) would not be limited to amounts that the investors pay for a shelter plan, but would also include amounts that the investors contribute to the shelter itself.

[3]To our knowledge, only one reported case addresses the penalty under § 6707, In re Mitchell, 109 B.R. 434 (Bankr. W.D. Wash, 1989); however, that case involved stipulated amounts and so provides little insight into the calculation of the penalty.

4. **What procedural rights exist to contest a penalty assessed under § 6707(a)(1)?**

Prior IRM 42(17)(12) provided a procedure for abating the penalty based on "reasonable cause." If the penalty was not abated, the taxpayer could file a written protest and request an Appeals conference. If Appeals did not abate the penalty, it would have to be paid upon notice and demand under § 6303. After payment of the penalty, the taxpayer could file a refund claim and, if necessary, a lawsuit to recover the penalty. We are aware that this section has been removed from the IRM. However, until the Service adopts an alternative procedure for assessing the § 6707 penalty, we believe that the prior procedure would still be followed.

We wish to supplement the above procedure by specifying that a taxpayer that wishes to litigate the § 6707 penalty must pay the penalty first. There is no pre-payment forum for litigating the § 6707 penalty. The Tax Court is a court of limited jurisdiction; that is, jurisdiction may be exercised by the Tax Court only to the extent specifically and expressly conferred on it by Congress. Generally, jurisdiction is conferred on the Tax Court: (1) to redetermine the correct amount of a deficiency or of transferee or fiduciary liability in income, estate, gift, and generation-skipping taxes, determined by the Commissioner; (2) to issue declaratory judgements as to certain limited types of tax disputes; and (3) to decide certain disclosure, administrative cost and partnership actions.

A penalty assessed under § 6707 is not within the jurisdiction conferred upon the Tax Court. Section 6211(a) specifies the term "deficiency" to mean the amount by which the tax imposed by subtitle A or B, or chapter 41, 42, 43, or 44 exceeds the excess of the sum of the amount shown as tax by the taxpayer upon his return plus the amounts previously assessed (or collected without assessment) over the amount of rebates. Section 6707 is found in Subtitle F, chapter 68. Thus, the term "deficiency" does not encompass a penalty due under § 6707 and the Service may assess and collect the penalty without issuing a notice of deficiency.

Certain penalties imposed by subchapter B of chapter 68 are explicitly exempted from the deficiency procedures. See §§ 6706(c) and 6713(c). An inference could arguably be drawn from such explicit exemptions that other penalties are subject to deficiency procedures if no explicit exemption has been provided. We would, however, reject such an inference based on the language of § 6211(a). In this context, we find it significant that the Tax Court has concluded that other penalties lacking such an explicit exemption are not subject to the deficiency procedures. See Medeiros v. Commissioner 77 T.C. 1255 (1981) (100 percent penalty assessment under § 6672 for taxes imposed under subtitle C not subject to Tax Court jurisdiction); Robertson v. Commissioner, 1983-32 T.C. Memo,

(Penalty imposed under § 6654(a) for underpayment of estimated tax attributable to tax shown on return not subject to Tax Court jurisdiction).

Please let us know if we can be of any further assistance in your development of this case.