Office of Chief Counsel
Internal Revenue Service
memorandum

Number: **201021021**
Release Date: 5/28/2010

CC:PA:02:MLucey
POSTN-102919-10

Via Facsimile

UIL: 6111.00-00, 6707.00-00

date: April 20, 2010

to: Judith E. Murphy
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from: Ashton P. Trice
Chief, Branch 2
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subject: Gross Income Derived for Purposes of Sections 6111 and 6707

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. For purposes of section 6111, does gross income derived by a person from providing aid, assistance, or advice with respect to a reportable transaction include fees received on or before October 22, 2004 if the aid, assistance, or advice was given after October 22, 2004 and before August 3, 2007?

2. For purposes of calculating the amount of the penalty imposed by section 6707 on a material advisor for failing to file a timely, accurate, and complete information return disclosing a listed transaction, does the term "gross income derived" include fees received on or before October 22, 2004?

CONCLUSION

For purposes of both sections 6111 and 6707, gross income derived from providing aid, assistance, or advice is not limited to only income derived on or after October 22, 2004.

LAW AND ANALYSIS

I. Gross Income for Purposes of Section 6111

The American Jobs Creation Act of 2004 (AJCA), Public Law 108-357 (118 Stat. 1418), amended section 6111 to require that a material advisor with respect to any reportable transaction make a return setting forth information describing the transaction, potential tax benefits, and other information prescribed by the Secretary. Section 6111(b)(1)(A) defines the term "material advisor" to mean any person (i) who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and (ii) who directly or indirectly derives gross income in excess of the threshold amount (or such other amount as may be prescribed by the Secretary) for such aid, assistance, or advice. The threshold amount is (i) $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons, and (ii) $250,000 in any other case. I.R.C. § 6111(b)(1)(B). Section 6111, as amended, is effective for transactions with respect to which material aid, assistance, or advice is provided after October 22, 2004.

The Service released temporary guidance on section 6111 in Notice 2004-80, 2004-2 C.B. 963, and Notice 2005-22, 2005-1 C.B. 756. These notices are effective for transactions with respect to which material aid, assistance, or advice is provided after October 22, 2004 and before August 3, 2007.[1] Notice 2004-80, section A(2), provides that, for purposes of section 6111, material advisor is defined in § 301.6112-1(c)(2).[2] The rules under § 301.6112-1(c)(2), (c)(3), and (d) (without regard to the provisions relating to a transaction required to be registered under former section 6111), including the minimum fee amounts for a listed transaction under § 301.6112-1(c)(3)(ii), apply for purposes of determining whether a person is a material advisor. Section 301.6112-1(c)(3)(iii) provides, in pertinent part, that in determining whether the minimum fee threshold is satisfied, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction that is a potentially abusive tax shelter are taken into account. For purposes of section 6111, the minimum fee threshold must be met independently for each transaction that is a potentially abusive tax shelter and aggregation of fees among transactions is not required. See Treas. Reg. § 301.6112-1(c)(3)(iii).[3]

Notice 2005-22, section 2, provides that a person will be treated as becoming a material advisor under section 6111 when all of the following events have occurred: (1) the

[1] T.D. 9351, 2007-38 I.R.B. 616, added § 301.6111-3 effective for transactions with respect to which a material advisor makes a tax statement on or after August 3, 2007. Treas. Reg. § 301.6111-3(d)(2)(i).
[2] The Notice's references to § 301.6112-1 are to that regulation as amended by T.D. 9108, 2004-1 C.B. 429. All cites to § 301.6112-1 in this advice are to that version as amended by T.D. 9108.
[3] In other words, the determination of whether a person is a material advisor with respect to a specific transaction is made on a transaction by transaction basis, even if the transactions are substantially similar.

material advisor makes a tax statement; (2) the material advisor receives (or expects to receive) the minimum (threshold) fees; and (3) the transaction is entered into by the taxpayer. Material advisors, including those who cease providing services to a taxpayer prior to the taxpayer entering into the transaction, must make reasonable and good faith efforts to determine whether the taxpayer entered into the transaction. Notice 2005-22, section 3, clarifies that for purposes of section 6111, disclosure is required for reportable transactions with respect to which a material advisor makes a tax statement (other than post-filing advice described in § 301.6112-1(c)(2)(iv)(A)) after October 22, 2004, regardless of whether any portion of the fee was received before October 22, 2004, or whether the transaction was entered into before October 22, 2004. This rule is supported by the fact that Congress specifically made section 6111 effective for transactions with respect to which material aid, assistance, or advice is provided after October 22, 2004, and did not make the effective date dependent on the timing of the fees. See P.L. 108-357, § 815(a); see also; H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. 386 (2004).

Therefore, as long as a person makes a tax statement after October 22, 2004, fees received before and after October 22, 2004 with respect to a reportable transaction are included as gross income derived from providing aid, assistance, or advice to a taxpayer for purposes of determining whether that person is a material advisor. In addition to fees actually received by the potential material advisor, fees that the potential material advisor expects to receive in the future from the reportable transaction are also included in the amount of gross income derived for section 6111 purposes.[4]

II. Gross Income Derived for Purposes of the Section 6707 Penalty

Section 816 of the AJCA amended section 6707 to impose a penalty on a person who fails to file a timely information return when required by section 6111 or files a return with false or incomplete information with respect to a reportable transaction.

When the section 6707 penalty is with respect to a listed transaction, the amount of the penalty is the greater of $200,000 or 50% of the "gross income derived by such person" with respect to the listed transaction before the date the return is filed under section 6111.[5] Section 6707 is effective for returns the due date for which is after October 22, 2004. See P.L. 108-357, § 816(a). Nothing in the statutory language setting the amount of the penalty, the effective date of the penalty nor the due date for a section 6111 return is dependent upon whether gross income was derived before or after the

[4] See Treas. Reg. § 301.6112-1(c)(2) providing, in pertinent part, that a person is a material advisor with respect to a transaction that is a potentially abusive tax shelter if the person *receives or expects to receive* at least a minimum fee with respect to the transaction and the person makes a tax statement. (emphasis added). See also Treas. Reg. § 301.6111-3(c)(3) (defining "derived" as receive or expect to receive).

[5] The amount of the section 6707 penalty for an information return required with respect to any reportable transaction other than a listed transaction is $50,000. If a material advisor intentionally fails to comply with section 6111 with respect to a listed transaction, the section 6707 penalty is the greater of $200,000 or 75% of the gross income derived before the return is filed. I.R.C. § 6707(b)(2)(flush language).

enactment of the AJCA. Accordingly, all gross income that is derived with respect to providing aid, assistance, or advice with respect to a listed transaction prior to filing a proper section 6111 return is included in calculating the amount of the section 6707 penalty.[6]

We also note that the Service may aggregate fees derived by a material advisor from each separate taxpayer for aid, assistance, or advice provided with respect to the listed transaction into which the taxpayers entered. Although fees derived from separate transactions may not be aggregated for purposes of determining whether an advisor meets the threshold amount under section 6111, the filing of a single section 6111 return is sufficient to cover all substantially similar transactions.[7] It is appropriate for the penalty for failing to file the section 6111 return to cover all the transactions that the return would cover. Therefore, the non-aggregation rule applicable to determining the threshold amount under section 6111 should not apply to determining the penalty amount under section 6707. Moreover, there is nothing in the statutory language of section 6707(b)(2) that puts a limit on what qualifies as "gross income derived …with respect to aid, assistance, or advice which is provided with respect to the listed transaction." As a result, all gross income derived with respect to a listed transaction, including all transactions substantially similar to the listed transaction, even those for which the person provided a tax statement but did not meet the gross income threshold, is includable in calculating the amount of section 6707 penalty for failing to timely file a complete and accurate return with respect to the listed transaction. A listed transaction will not be treated as a reportable transaction, however, if it affected the taxpayer's federal income tax liability reported on a return filed on or before February 28, 2000. See Temp. Treas. Reg. 1.6011-4T(b)(2) as amended by T.D. 9000, 2002-2 C.B. 87. Therefore, fees received by an advisor for such transactions are not included for purposes of determining the penalty amount.

Please contact Matthew D. Lucey at (202) 622-4940 for additional questions regarding section 6707, or Caroline E. Hay at (202) 622-3070 for additional questions regarding section 6111.

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[6] The proposed regulations under section 6707 provide that the term "derive" for purposes of section 6707 means "derive" as defined by the § 301.6111-3(c)(3) regulations. See Prop. Treas. Reg. § 301.6707-1(b)(7). Section 301.6111-3(c)(3) defines derive to mean receive or expect to receive. As a result, gross income actually received after the filing of a section 6111 return would be included in calculating the amount of the section 6707 penalty with respect to a listed transaction if the material advisor expected to receive the income before filing a delinquent return.

[7] See Notice 2004-80, section 3 (A material advisor may file a single Form 8264 for substantially similar transactions.) and Notice 2005-22, section 2, (Once a material advisor has filed an information return with respect to a transaction, the material advisor is not required to file additional returns for each additional taxpayer that enters into the same transaction or for separate transactions that are substantially similar to the transaction for which the material advisor filed the information return.); see also Treas. Reg. § 301.6111-3(d)(1).