

Office of Chief Counsel
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memorandum

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to: Lehman Dry
Manager
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from: Tara P. Volungis
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subject: Disclosure of Loss Transaction Reportable Transactions

This Chief Counsel Advice responds to your request for assistance regarding whether certain taxpayers have a disclosure obligation under § 1.6011-4 of the Income Tax Regulations with respect to loss transactions in some commonly seen situations, and whether certain information routinely included on Form 8886, Reportable Transaction Disclosure Statement, is complete for purposes of § 1.6011-4(d). In accordance with § 6110(k)(3) of the Internal Revenue Code, this Chief Counsel Advice should not be used or cited as precedent.

ISSUES

1. Whether the taxpayers in *Situation 1* and *Situation 2*, described below, have disclosure obligations under § 1.6011-4 as a result of claiming losses under § 165; and
2. Whether the disclosure statements provided by the taxpayers in *Situation 3* and *Situation 4*, described below, are complete under § 1.6011-4(d).

CONCLUSIONS

1. *Situation 1*

Taxpayer1 in *Situation 1* has a disclosure obligation under § 1.6011-4(a) only with respect to Transaction3 and Transaction4. Each of the two corporate partners of Taxpayer1 have disclosure obligations under § 1.6011-4(a) only with respect to Transaction4.

Situation 2

Taxpayer2 in *Situation 2* has a disclosure obligation under § 1.6011-4(a) with respect to Transaction5 and Transaction6. Partner A of Taxpayer2 has a disclosure obligation under § 1.6011-4(a) only with respect to Transaction 5. Partner B of Taxpayer2 does not have a disclosure obligation under § 1.6011-4(a) with respect to either Transaction5 or Transaction6.

2. *Situation 3*

The disclosure statement filed by Taxpayer3 in *Situation 3* does not satisfy the requirements of § 1.6011-4(d) and, therefore, fails to comply with the disclosure requirements of § 1.6011-4.

Situation 4

The disclosure statement filed by Taxpayer4 in *Situation 4* does not satisfy the requirements of § 1.6011-4(d) and, therefore, fails to comply with the disclosure requirements of § 1.6011-4.

LAW

Section 1.6011-4(a)¹ provides that every taxpayer that has participated, as described in § 1.6011-4(c)(3), in a reportable transaction within the meaning of § 1.6011-4(b) and who is required to file a tax return must file within the time prescribed in § 1.6011-4(e) a disclosure statement in the form prescribed by § 1.6011-4(d).

Section 1.6011-4(b)(1) provides that a reportable transaction is a transaction described in § 1.6011-4(b)(2) through (7). The term transaction 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.

Section 1.6011-4(b)(5)(i) provides that a loss transaction is any transaction resulting in the taxpayer claiming a loss under § 165 of at least (A) \$10 million in any single taxable year or \$20 million in any combination of taxable years for corporations; (B) \$10 million in any single taxable year or \$20 million 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

¹ All references to § 1.6011-4 are to § 1.6011-4 as amended in T.D. 9350, 2007-2 C.B. 607, and generally effective for transactions entered into on or after August 3, 2007.

one or more partners; (C) \$2 million in any single taxable year or \$4 million in any combination of taxable years for all other partnerships, whether or not any losses flow through to one or more partners; (D) \$2 million in any single taxable year or \$4 million 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 (E) \$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 § 988 transaction (as defined in § 988(c)(1) relating to foreign currency transactions).

Section 1.6011-4(b)(5)(iii)(A) provides that, for purposes of § 1.6011-4, in determining the thresholds in § 1.6011-4(b)(5)(i), the amount of a § 165 loss is adjusted for any salvage value and for any insurance or other compensation received. See § 1.165-1(c)(4). However, a § 165 loss does not take into account offsetting gains, or other income or limitations. For example, a § 165 loss does not take into account the limitation in § 165(d) (relating to wagering losses) or the limitations in §§ 165(f), 1211, and 1212 (relating to capital losses). The full amount of a § 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 § 172 or a net capital loss under § 1212 that is a carryback or carryover to another year. A § 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 § 1212.

Section 1.6011-4(b)(5)(iii)(B) provides that for purposes of § 1.6011-4, a § 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 § 165. A § 165 loss includes, for example, a loss resulting from a sale or exchange of a partnership interest under § 741 and a loss resulting from a § 988 transaction.

Revenue Procedure 2004-66 provides that certain losses are not taken into account in determining whether a transaction is a reportable transaction for purposes of the disclosure rules under § 1.6011-4(b)(5).

Section 1.6011-4(c)(3)(i)(D) provides that a taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a § 165 loss and the amount of the § 165 loss equals or exceeds the threshold amount applicable to the taxpayer as described in § 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 § 165 loss as described in § 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 § 165 loss and the amount of the § 165 loss that flows through to the taxpayer equals or exceeds the threshold amounts applicable to the taxpayer as described in § 1.6011-4(b)(5)(i). For this purpose, a tax return is deemed to reflect the full amount of a § 165 loss described in § 1.6011-4(b)(5) allocable to the taxpayer under § 1.6011-4(c)(3)(i)(D), regardless of whether all or part of the loss enters into the computation of a net operating loss under § 172 or net capital loss under § 1212 that the taxpayer may carry back or carry over to another year.

Section 1.6011-4(c)(4) provides, in part, that the term “substantially similar” 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.

Section 1.6011-4(d) provides that a taxpayer required to file a disclosure statement under § 1.6011-4 must file a completed Form 8886, Reportable Transaction Disclosure Statement, in accordance with § 1.6011-4(d) and the instructions to the form. The form must be attached to the appropriate tax return as provided in § 1.6011-4(e). To be considered complete, the information provided on the form must describe the expected tax treatment and all potential tax benefits expected to result from the transaction, describe any tax result protection (as defined in § 301.6111-3(c)(12)) with respect to the transaction, and identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and the identity of all parties involved in the transaction. An incomplete Form 8886 containing a statement that information will be provided upon request is not considered a complete disclosure statement. If the form is not completed in accordance with the provisions of § 1.6011-4(d) and the instructions to the form, the taxpayer will not be considered to have complied with the disclosure requirements of § 1.6011-4.

Section 1.6011-4(e) provides the time for filing the disclosure statement.

Section 1.6011-4(f)(2) provides that if a taxpayer is uncertain whether a transaction must be disclosed under § 1.6011-4, the taxpayer may disclose the transaction in accordance with the requirements of § 1.6011-4 and comply with all the provisions of § 1.6011-4, and indicate on the disclosure statement that the disclosure statement is being filed on a protective basis. The IRS will not treat disclosure statements filed on a protective basis any differently than other disclosure statements filed under § 1.6011-4. For a protective disclosure to be effective, the taxpayer must comply with these disclosure regulations by providing to the IRS all information requested by the IRS under § 1.6011-4.

The instructions to Form 8886 state that, generally, only one transaction may be reported on the form. However, the instructions further state that more than one transaction may be reported on one form if the transactions are the same or substantially similar.

FACTS & ANALYSIS

The situations presented below are hypothetical. In addition, each of the factual situations discussed assumes that the transactions are not otherwise reportable transactions as described in § 1.6011-4(b)(2)-(4), (6), and (7).

1. Whether the taxpayers in *Situation 1* and *Situation 2* have disclosure obligations under § 1.6011-4 as a result of claiming losses under § 165.

Situation 1

Taxpayer1 is a partnership with two corporate partners. Each partner of Taxpayer1 has a 50% interest in Taxpayer1, and items of income, gain, loss, deduction and credit are allocated based on their interest in Taxpayer1. In Year1, Taxpayer1 enters into four transactions, which are not part of a series of steps carried out as part of a plan, with the following results:

Transaction1: § 165 loss of \$30 million and the loss is described in section 4 of Rev. Proc. 2004-66, 2004-2 C.B. 966;

Transaction2: § 165 loss of \$9 million and the loss is not described in section 4 of Rev. Proc. 2004-66;

Transaction3: § 165 loss of \$12 million and the loss is not described in section 4 of Rev. Proc. 2004-66; and

Transaction4: § 165 loss of \$30 million and the loss is not described in section 4 of Rev. Proc. 2004-66.

None of the losses arise with respect to a § 988 transaction. Taxpayer1's Year1 tax return reflects the results of each of these transactions. The results of these transactions are also reflected on the Year1 tax returns of Taxpayer1's two partners.

For purposes of applying the rules under § 1.6011-4, each transaction is considered separately because the transactions were not a series of steps carried out as part of a plan. Thus, the transactions are not aggregated in determining whether the threshold amount is exceeded.

With respect to Transaction1, Taxpayer1 claims a \$30 million § 165 loss. Taxpayer1 is not required to take this loss into account under § 1.6011-4(b)(5), because the loss is described under section 4 of Rev. Proc. 2004-66 as a loss not taken into account in determining if a transaction is a reportable transaction. Therefore, Transaction1 is not a reportable transaction with respect to Taxpayer1. Taxpayer1 is not required to disclose Transaction1 on Form 8886 under § 1.6011-4. Because Transaction1 is not a reportable transaction, the partners of Taxpayer1 are not required to disclose the losses from Transaction1 that flow through Taxpayer1 to the partners.

With respect to Transaction2, Taxpayer1 claims a \$9 million § 165 loss. The loss that results from Transaction2 is not described under section 4 of Rev. Proc. 2004-66. However, the amount of the § 165 loss does not equal or exceed the threshold amount applicable to partnerships with corporate partners described in § 1.6011-4(b)(5)(i)(B). Therefore, Transaction2 is not a reportable transaction with respect to Taxpayer1. Taxpayer1 is not required to disclose Transaction2 on Form 8886 under § 1.6011-4. Because Transaction2 is not a reportable transaction, the partners of Taxpayer1 are not required to disclose the losses from Transaction2 that flow through Taxpayer1 to the partners.

With respect to Transaction3, Taxpayer1 claims a \$12 million § 165 loss. The loss that results from Transaction3 is not described under section 4 of Rev. Proc. 2004-66. The amount of the § 165 loss exceeds the threshold amount described in § 1.6011-4(b)(5)(i)(B). Because the loss from Transaction3 exceeds the threshold amount, the transaction is a reportable transaction under § 1.6011-4(b)(5) with respect to Taxpayer1. Taxpayer1's tax return reflects the loss from Transaction3 in Year1; therefore, Taxpayer1 participated in a reportable transaction in Year1 under § 1.6011-4(c)(3)(i)(D), and must disclose Transaction3 on Form 8886 as required by § 1.6011-4(e). With respect to Transaction3, the partners of Taxpayer1 each claim a \$6 million § 165 loss. For each partner, the amount of the § 165 loss does not equal or exceed the threshold amount applicable to corporations described in § 1.6011-4(b)(5)(i)(A). Therefore, Transaction3 is not a reportable transaction with respect to the partners. The partners of Taxpayer1 are not required to disclose the losses from Transaction3 that flow through Taxpayer1 to the partners.

With respect to Transaction4, Taxpayer1 claims a \$30 million § 165 loss. The loss that results from Transaction4 is not described under section 4 of Rev. Proc. 2004-66. The amount of the § 165 loss exceeds the threshold amount described in § 1.6011-4(b)(5)(i)(B). Because the loss from Transaction4 exceeds the threshold amount, the transaction is a reportable transaction under § 1.6011-4(b)(5) with respect to Taxpayer1. Taxpayer1's tax return reflects the loss from Transaction4 in Year1; therefore, Taxpayer1 participated in a reportable transaction in Year1 under § 1.6011-4(c)(3)(i)(D), and must disclose Transaction4 on Form 8886 as required by § 1.6011-4(e). With respect to Transaction4, the partners of Taxpayer1 each claim a \$15 million § 165 loss. For each partner, the amount of the § 165 loss exceeds the threshold amount described in § 1.6011-4(b)(5)(i)(A). Because the loss from Transaction4 exceeds the threshold amount for each partner, the transaction is a reportable transaction under § 1.6011-4(b)(5) with respect to the partners. Each of the partners' tax returns reflect the loss from Transaction4 in Year1; therefore, each of the partners participated in a reportable transaction in Year1 under § 1.6011-4(c)(3)(i)(D), and must disclose Transaction4 on Form 8886 as required by § 1.6011-4(e).

Taxpayer1 participated in two loss transactions under § 1.6011-4(b)(5), Transaction3 and Transaction4. If Transaction3 is the same as or substantially similar to Transaction4, then both Transaction3 and Transaction4 may be disclosed on the

same Form 8886. If the transactions are not the same or substantially similar, then separate Forms 8886 must be filed.

Situation 2

Taxpayer2 is a partnership with two individual partners, A and B. A and B have a 90% interest and a 10% interest, respectively, in Taxpayer2, and items of income, gain, loss, deduction and credit are allocated based on their interests in Taxpayer2. In Year2, Taxpayer2 enters into two transactions, Transaction5 and Transaction6, and incurs § 165 losses in the amount of \$3 million and \$2 million, respectively. Neither of the losses are described in section 4 of Rev. Proc. 2004-66, nor do the losses arise with respect to a § 988 transaction. Taxpayer2's taxable year Year2 tax return reflects each of these transactions. These transactions are also reflected on the Year2 tax returns of A and B.

With respect to Transaction5 and Transaction6, Taxpayer2 claims a \$3 million § 165 loss and a \$2 million § 165 loss, respectively. Both of the amounts of the § 165 losses equal or exceed the threshold amount applicable to partnerships described in § 1.6011-4(b)(5)(i)(C). Because each of the losses from Transaction5 and Transaction6 equals or exceeds the threshold amount, both of the transactions are reportable transactions under § 1.6011-4(b)(5) with respect to Taxpayer2. Taxpayer2's tax return reflects the losses from Transaction5 and Transaction6 in Year2; therefore, Taxpayer2 participated in two reportable transactions in Year2 under § 1.6011-4(c)(3)(i)(D), and must disclose Transaction5 and Transaction6 as required by § 1.6011-4(e). If Transaction5 is the same as or substantially similar to Transaction6, then both Transaction5 and Transaction6 may be disclosed on the same Form 8886. If the transactions are not the same or substantially similar, then separate Forms 8886 must be filed.

With respect to Transaction5, A, the 90% partner in Taxpayer2, claims a \$2.7 million § 165 loss. The amount of the § 165 loss exceeds the threshold amount applicable to individuals described in § 1.6011-4(b)(5)(i)(D). Because the loss from Transaction5 exceeds the threshold amount, the transaction is a reportable transaction under § 1.6011-4(b)(5) with respect to A. A's tax return reflects the loss from Transaction5 in Year2; therefore, A participated in a reportable transaction in Year2 under § 1.6011-4(c)(3)(i)(D), and must disclose Transaction5 on Form 8886 as required by § 1.6011-4(e). With respect to Transaction6, A claims a \$1.8 million § 165 loss. The amount of the § 165 loss does not equal or exceed the threshold amount described in § 1.6011-4(b)(5)(i)(D). Therefore, Transaction6 is not a reportable transaction with respect to A. A is not required to disclose the loss from Transaction6 that flows through Taxpayer2 to A.

With respect to Transaction5 and Transaction6, B, the 10% partner in Taxpayer2, claims a \$300,000 § 165 loss and a \$200,000 § 165 loss, respectively. Neither of the amounts of the § 165 losses equal or exceed the threshold amount applicable to

individuals described in § 1.6011-4(b)(5)(i)(D). Therefore, Transaction5 and Transaction6 are not reportable transactions with respect to B. B is not required to disclose the losses from Transaction5 and Transaction6 that flow through Taxpayer2 to B.

2. Whether the disclosure statements provided by the taxpayers in *Situation 3* and *Situation 4*, described below, are complete under § 1.6011-4(d).

Situation 3

Taxpayer3 is the top tier entity of a tiered investment partnership (commonly referred to as a “fund-of-funds” or “master-feeder fund”) with some partners that are not corporations. In other words, Taxpayer3 is a partnership that is a partner in another partnership that is a partner in yet another partnership. In Year3, lower-tier entities of Taxpayer3 engage in numerous transactions that result in § 165 losses that exceed \$2 million. Some, but not all, of the transactions result in § 165 losses that are losses described in Rev. Proc. 2004-66 as not subject to the disclosure requirements of § 1.6011-4. Taxpayer3 attaches to its Year3 tax return a Form 8886 that states, in part, “due to the nature and volume of Taxpayer3’s activities, it is not practical to determine whether the applicable reportable loss thresholds are exceeded for any specific transaction or to determine with certainty whether any specific transaction has met any of the exceptions provided in Rev. Proc. 2004-66. Taxpayer3 is reporting these transactions on a protective basis.” The disclosure provides no details about the transactions. In addition, lower-tier entities of Taxpayer3 attach an identical or almost identical Form 8886 to their respective tax returns.

Taxpayer3 must disclose each loss transaction that meets the requirements of § 1.6011-4(b)(5) under § 1.6011-4(a). Each § 165 loss is considered a separate transaction (as long as multiple transactions are not part of a series of steps carried out as part of a plan). Each loss transaction must be disclosed separately on Form 8886, however, if the loss transactions are the same or substantially similar, the transactions may be disclosed on a single Form 8886.

The disclosure statement provided by Taxpayer3 fails to describe the expected tax treatment and all potential tax benefits expected to result from each loss transaction and to identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and the identity of all parties involved in the transaction. Therefore, Taxpayer3’s disclosure fails to satisfy the requirements of § 1.6011-4(d). The IRS will not treat disclosure statements filed on a protective basis any differently than other disclosure statements filed under § 1.6011-4. In addition, for the reasons discussed above, the lower-tier entities of Taxpayer3 that participated in loss transactions but merely attached a Form 8886 identical to the Form 8886 filed by Taxpayer3 failed to adequately disclose under § 1.6011-4.

Situation 4

