SECTION OF TAXATION
State Bar of Texas

December 21, 2007

The Honorable Eric Solomon
Assistant Secretary for Tax Policy
Department of the Treasury
Room 3120 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Linda E. Stiff
Acting Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, DC 20224

RE: Comments on Proposed Treasury Regulations under Section 6011 and Section 6111 (REG-129916-07).

Dear Assistant Secretary Solomon and Acting Commissioner Stiff:

On September 25, 2007, the Department of Treasury (the "Treasury") and the Internal Revenue Service (the "Service") issued a notice of proposed rulemaking regarding sections 6011 and 6111 of the Internal Revenue Code (the "Code"). The Treasury and the Service requested comments on the regulations proposed in that notice by December 26, 2007, and the following comments are submitted in response to that request. On behalf of the Section of Taxation of the State Bar of Texas, I am pleased to submit the enclosed comments concerning those proposed regulations.

THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE SECTION OF TAXATION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE SECTION OF TAXATION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW.

THE COMMENTS ARE SUBMITTED AS A RESULT OF THE APPROVAL OF THE COMMITTEE ON GOVERNMENT SUBMISSIONS OF THE SECTION OF TAXATION AND PURSUANT TO THE PROCEDURES ADOPTED BY THE COUNCIL OF THE SECTION OF TAXATION, WHICH IS THE GOVERNING BODY OF THAT SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE SECTION OF TAXATION WHO PREPARED THEM.

We commend the Department of the Treasury and the Internal Revenue Service for providing guidance in this area, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

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Chair, Section of Taxation
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COMMENTS ON PROPOSED TREASURY REGULATIONS UNDER SECTIONS 6011, 6111 AND 6112

The following comments are the individual views of the members of the Section of Taxation (the "Section") who prepared them and do not represent the position of the State Bar of Texas or the Section.

These comments were prepared by individual members of the Section's Tax Controversy Committee (the "Committee"). Principal responsibility was exercised by the Chair of the Committee, M. Todd Welty, and by two other members of the Section, Patrick L. O'Daniel and Stephen A. Beck. The Comments were reviewed by Paul Asofsky, a member of the Section's Committee on Government Submissions, and by the Chair of the Section, Kevin Thomason.

Although many of the people who participated in preparing, reviewing and approving these comments have clients who will be affected by the federal tax law principles addressed by these comments and frequently advise clients on the application of such principles, none of the participants (or the firms or organizations to which such participants belong) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the subject matter of these comments.

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Date: December 21, 2007

I. EXECUTIVE SUMMARY.

The following comments are submitted in response to a request for comments made by the Department of Treasury (the "Treasury") and the Internal Revenue Service (the "Service") in the notice of proposed rulemaking issued on September 25, 2007 regarding sections 6011 and 6111 of the Internal Revenue Code (the "Code"). The Treasury and the Service requested comments by December 26, 2007.

The following is a summary of our comments.

We generally agree with the approach taken by the Treasury and the Service in requiring disclosure of patented tax strategies. However, we have two comments regarding the scope of "participation" under section 1.6011-4(c)(3)(i)(F) of the proposed regulations.

First, we suggest that a taxpayer paying a fee for the right to use the tax strategy should not be considered as having participated in the patented transaction merely by reason of deducting such fees because those deductions represent true economic, out-of-pocket costs incurred by the taxpayer and do not result from the implementation of the patented tax strategy. Requiring disclosure solely because of the deduction of fees could cause some taxpayers to be subject to the disclosure requirement even though they ultimately decide not to report any tax benefits from the patented tax strategy.

Second, we suggest that a patent holder should be considered as having participated in the patented transaction merely from the filing of the patent application, regardless of whether the patent holder deducted any expenses incurred in the process of obtaining the patent. This would prevent unnecessary delay in the government's ability to examine the merits of a transaction that could otherwise be caused by the patent holder simply choosing not to claim any deductions from the patent application process.

II. BACKGROUND.

On November 1, 2006, the Treasury and the Service issued a notice of proposed rulemaking and temporary and final regulations under Code sections 6011, 6111, 6112. In the preamble to the proposed regulations, the Treasury Department and the Service expressed concern regarding the patenting of tax strategies and requested comments regarding the appropriate treatment of patented tax strategies under the reportable transaction rules, including whether a new category of reportable transaction should be created to address patented tax strategies.

The Section of Taxation of the State Bar of Texas submitted comments suggesting that disclosure be required under Code section 6011 for every process involving the application of federal tax law that is the subject of an application for a patent or granted patent. In addition,

those comments suggested that every party who files an application for a patent, or for whom a patent is granted, with regard to a process involving the application of federal tax law be considered a material advisor, thereby requiring such party to file a disclosure statement and investor list with respect to that process.

On September 25, 2007, the Treasury and the Service issued a notice of proposed rulemaking containing proposed regulations under Code sections 6011 and 6111 that would create a new category of reportable transactions under Code section 6011 for certain "patented transactions" and would define which parties are material advisors, and therefore subject to the list maintenance requirements, with respect to such transactions.

In this notice of proposed rulemaking, the Treasury and the Service requested comments with regard to the proposed regulations and, in particular, on the clarity of the proposed rules, how they could be made easier to understand, and the administrability of the rules in the proposed regulations.

III. COMMENTS.

We commend the Treasury and the Service for its thoughtful and appropriate response to the issue of patented tax strategies. The required disclosure of patented tax strategies is an important mechanism for ensuring that the Treasury and the Service receive information regarding transactions that could potentially be mass-marketed to the public under the false representation that the propriety of the underlying tax strategy has been approved by the government.

We generally agree with the approach taken by the Treasury and the Service in the proposed regulations and commend the Treasury and the Service for devising a firm, but even-handed, solution for monitoring patented tax strategies. However, we would like to comment on some narrow issues implicated by the proposed regulations. We appreciate this opportunity to comment and hope that our comments prove helpful.

Our comments relate to the proposed scope of "participation" in a patented transaction in section 1.6011-4(c)(3)(i)(F) of the proposed regulations. From the standpoint of a taxpayer who has been sold a patented tax strategy by a promoter, the "participation" concept, as currently drafted, may be overly broad because participation may be triggered merely by the payment of a fee from the taxpayer to the promoter. Thus, an out of pocket, economic cost incurred by the taxpayer can result in such taxpayer being subject to the disclosure requirements, even though the taxpayer's return for that year may not reflect any tax benefits resulting from the implementation of the patented tax strategy. Indeed, disclosure would be required as a result of the payment of the fee even if the taxpayer ultimately decided not to utilize the patented tax strategy and never claimed any tax benefits it.

In contrast, from the standpoint of the patent holder, the "participation" concept, by partially relying on the claiming of tax benefits with respect to the obtaining of the patent, may not be broad enough. The party applying for a patent with regard to a tax strategy may simply not claim any deductions for its expenses incurred in the application process. This would defer the time at which that party would be required to make any disclosures with regard to the underlying tax strategy and would delay the ability of Treasury and the Service to examine the merits of such strategy under the federal tax authorities. This delay could result in additional taxpayers being lured into using inappropriate tax strategies through representations that the patent is an indication of governmental approval of the strategy.

Instead of being tied to the claiming of tax benefits, "participation" should result from the mere filing of an application for a patent for any process involving the application of federal tax law. This would prevent the above described delay in the government's ability to learn of and examine the strategy underlying the patent application.