

October 2004

About this newsletter

This is the first in a series of updates about tax shelters in Illinois.

The purpose of the **TAX SHELTER Update** is to provide a brief overview of the progress of implementing the new tax shelter laws in Illinois. The department has previously provided a brochure and a bulletin regarding the Tax Shelter Voluntary Compliance Program (VCP).

General Information

Illinois has joined the IRS and a number of other states in a cooperative effort to eliminate potentially abusive tax avoidance transactions, commonly known as abusive tax shelters.

The IRS estimates that participation in abusive tax shelters cost the GAO \$12-15 billion each year. The result is a loss of \$60-75 million in Illinois. When taxpayers employ abusive tax shelters to avoid taxes, they force honest tax payers to carry the financial burden.

What is involved in the Illinois effort?

Illinois has taken several steps to identify tax shelter participants and promoters. As part of the Illinois initiative,

- the General Assembly has enacted new penalties and additional reporting requirements for both use and promotion of abusive tax shelters;
- the department has assembled a trained team of auditors and lawyers dedicated to identifying abusive tax shelters
- the department has entered into agreements to exchange information with the Internal Revenue Service and with a consortium of 48 states, that have created a database of taxpayers using abusive tax shelters
- the department, along with other states and the IRS, will be seeking and sharing client lists from promoters who sell abusive tax shelters.

What is an abusive tax shelter?

An abusive tax shelter is a plan or arrangement devised for the principal purpose of avoiding payment of federal or state income tax. Abusive tax shelters include, but are not limited to "listed transactions" defined by the Internal Revenue Service.

For detailed information about listed transaction, visit the IRS web site at <http://www.irs.gov/businesses/corporations/index.html>.

How do I know if I'm involved in an abusive tax shelter?

The following is a list of questions taxpayers may ask themselves to help decide if they are involved in an abusive tax shelter transaction.

- *Is the tax loss, deduction, or credit a significant amount compared to your investment, and is it used to offset income from unrelated transactions?*
- *Is your economic and out-of-pocket loss minimal compared to the tax benefits realized?*
- *Does the transaction lack a business purpose other than reduction of income taxes?*
- *Does the transaction lack a reasonable possibility of making a profit?*
- *Are multiple entities involved to unnecessarily complicate the transaction*
- *Does the tax position ignore the true intent of relevant statutes and regulations?*
- *Does the transaction produce a tax result that is too good to be true?*

If you answered "yes" to any of the above questions, you are most likely dealing with a potentially abusive tax avoidance transaction.

Note → Remember, if it sounds too good to be true, it probably is.

What is the department doing currently?

On October 15, 2004, the department kicked off the Tax Shelter Voluntary Compliance program. During the months of October, November, December, and January, letters are being issued to various groups of taxpayers and tax professionals to encourage their participation in the VCP.

Notification of the VCP was provided in brochure and bulletin format in September and October. If you would like to read more about the VCP, visit our web site at www.ILtax.com and click on the VCP logo.

More information was provided with help from media sources. IDOR Director Brian Hamer issued a press conference in Chicago on October 18, 2004, and was featured October 22, 2004, on the local Springfield newscast discussing abusive tax shelters.

In addition, the department is continually working to implement efficient ways of working with taxpayers during the VCP, as well as developing tracking systems and databases that will help us to provide our abusive tax shelter findings to the IRS and multi-state consortium.

The section of the department's web pages will be periodically updated and provide more frequently asked questions and answers as we are able to compile the various issues and concerns that are presented to IDOR staff.