

United States Department of Justice Report on an actual Son of Boss tax shelter case

ATTACHMENT 1

This case involves a "Son of Boss" abusive tax shelter transaction. This tax shelter originated from a so-called "Boss" (bond and option sales strategy) tax shelter that purported to create deductible losses on the disposition of stock with artificially high basis. The "Son of Boss" tax shelters involve similar tax avoidance schemes designed to produce non-economic tax losses on the disposition of a partnership interest with an artificially high basis. On the surface, the case involves plaintiff's challenge, as the tax-matters partner for a TEFRA partnership, of the disallowance by the IRS of \$102,563,057 in artificial losses claimed by ██████████, L.P. on its 1999 tax return. Plaintiff also challenges the imposition by the IRS of a 20% accuracy penalty.

Operating through a trust and several partnerships, on December 27, 1999, ██████████, as trustee for the ██████████ Family Trust I opened a margin account with an investment/brokerage firm. ██████████ then entered into multiple short sale transactions using U.S. Treasury Notes borrowed from the investment/brokerage firm. As part of the agreement to borrow the notes, Mr. ██████████ or one of the trust and/or partnerships controlled by him, was obligated to later replace the borrowed notes. On December 27, 1999 and December 28, 1999, cash proceeds from the short sales (\$102,563,056), plus the obligation to replace the borrowed notes, was transferred among one or more different partnerships also controlled by ██████████. On December 30, 1999, the partnership holding **both the cash proceeds and the repurchase obligation** was sold to a different partnership, allegedly controlled by a third party. As a result of the December 30, 1999 sale, ██████████ claimed a loss of \$102,740,873 based on the value of the cash proceeds transferred among the various partnerships without affording any corresponding reduction in basis due to the fact that the obligation to repurchase the notes was also transferred and, in fact, fulfilled by one of the transferee partnerships. As previously noted, \$102,563,056 of the artificial loss was disallowed by the IRS.

\$102,638,673 of the \$102,740,873 artificial loss reported on the ██████████ L.P. return was passed through to the ██████████ Family Trust I. Between its returns for tax years 1999, 2000 and 2001, the ██████████ Family Trust has attempted to utilize \$2,386,500 of these artificial losses, resulting in an aggregate tax underpayment of approximately \$841,168.

This is a textbook example of a Son of Boss abusive tax shelter. In this type of Son of Boss transaction, the investor borrows the U.S. Treasury Notes from an investment/brokerage firm and sells the notes on the open market. While the investor is required to purchase replacement U.S. Treasury Notes on the open market at a date in the future and return them to the brokerage firm, the investor transfers the brokerage account and the obligation to return the U.S. Treasury Notes to a partnership in return for an interest in the partnership. The investor then asserts an exaggerated basis in its partnership interest, arguing that its basis in the partnership interest is not reduced by the amount of the obligation assumed by the partnership. On the disposition of the partnership interest or the liquidation of the partnership, the investor claims a tax loss, even though the investor has incurred no corresponding economic loss.

These "Son of Boss" tax shelter transactions are widespread and can result in enormous artificial tax losses to purported investors. Here, the imposition of the accuracy penalty is

particularly significant in that [REDACTED] was a promoter of similar Son of Boss abusive tax shelters and he knew or should have known that the artificial losses were invalid. Additionally, presumably much of the income which he is attempting to shelter will flow from his promotion of this abusive tax avoidance scheme.