Caplin & Drysdale

taxAlert

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We are writing to alert you to three major developments in the tax law that business taxpayers should focus on immediately. The first article addresses a new pre-filing procedure available to larger businesses, the second discusses a report that may affect all multinational businesses with transfer pricing issues, and the third should be of interest to anyone who is concerned about keeping tax information private.

This taxAlert is published by Caplin & Drysdale, a Washington, D.C.-based tax and litigation law firm. The firm's thirty tax lawyers have been designing creative, successful tax strategies for companies, organizations, and individuals throughout the United States and around the world since the firm was founded by Mortimer Caplin, former IRS Commissioner, 35 years ago. Our attorneys not only understand the tax laws, but play key roles in their development. If you would like additional information on any of the topics discussed in this Alert, please contact Patricia G. Lewis (202-862-5017, pgl@capdale.com) or Christopher S. Rizek (202-862-8852, csr@capdale.com).

A New Way to Resolve a Factual Issue With the IRS Before Filing a Return

On February 11, 2000, the IRS issued a long-awaited notice creating a program for Pre-Filing Agreements (PFAs) with taxpayers. This program will, for the first time, provide taxpayers an opportunity to obtain binding determinations by the IRS on many factual issues before a return is filed.

The PFA program will initially be administered by the newly-organized Large and Mid-Size Business (LMSB) division. For now, the IRS is running only a pilot project for large taxpayers who are in the Coordinated Examination Program (CEP) and have returns due to be filed between September and December, 2000. Although the IRS expects to enter only 5 to 10 actual PFAs in the first year of the program, the success of this major procedural initiative could be critical to the IRS's ongoing reorganization. Interested taxpayers may therefore have a chance to work with the IRS on the ground floor of this process.

The IRS will only consider a PFA on an issue as to which the legal principles (as distinct from the facts) are "settled." Examples given by the IRS of appropriate topics include valuation issues, hedging transactions, allocations of costs, start-up costs, appropriate asset classes, and so on. The IRS will not consider matters for which there are other IRS programs, including transfer pricing issues and changes in methods of accounting, or for which the taxpayer has already sought a legal ruling. The PFA program also will not address transactions that lack a bona fide business purpose or that have the principal purpose of reducing federal taxes, certain litigation issues, or issues that relate to penalties or sanctions or to certain exceptions from such penalties (such as reasonable cause, due diligence, etc.).

A taxpayer whose request to participate in the PFA pilot project is granted can expect a fairly in-depth examination, but it will be over relatively quickly — the goal is 6 months, much shorter than many CEP examinations of an issue. Moreover, the IRS will be seeking successful resolutions of issues to make the program work. Requests to participate in the pilot project must be submitted very soon — *by March 15, 2000.*

If you have an issue that you think might be appropriate for the PFA pilot project, please call us. Caplin & Drysdale is familiar not only with this new procedure and the reorganized IRS, but also with the many related procedural and substantive issues (*see related articles in this Alert*) that are bound to arise as the PFA pilot project gets under way.

The IRS APA Report – What It Could Mean For You

In legislation enacted late in 1999, Congress required the Treasury Department and the IRS to prepare an omnibus report summarizing key features and provisions of all of the Advance Pricing Agreements (APAs) completed since the APA Program began in 1990. An APA is a formal agreement between the IRS and a taxpayer concerning the pricing of cross-border related-party transactions. The APA Report is due by March 31, 2000. The APA Report could help you fine-tune your current transfer pricing practices, determine whether an APA makes sense for your business, or even change your strategy in current APA negotiations.

Congress imposed the APA Report requirement in response to litigation

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brought by the Bureau of National Affairs (BNA) to require disclosure of APAs under the Freedom of Information Act. In the litigation, the IRS had, surprisingly, agreed with BNA to disclose all completed APAs, notwithstanding prior confidentiality assurances to the taxpayers involved. Caplin & Drysdale, long involved in transfer pricing matters and APAs, fought to protect taxpayers from unwarranted disclosure of their pre-existing APAs and related background information, by filing an *amicus curiae* brief. Our actions forced the court to deliberate over the legal issues and helped to provide adequate time for a debate on the policy issues before Congress. Ultimately, our defense of the confidentiality of APAs was vindicated by Congress's enactment of protective legislation. (*See related article in this Alert.*)

The new legislation ensures the confidentiality of individual APAs, while at the same time providing for publication of generic information, through the APA Report, on how the IRS administers transfer pricing rules through the APA Program.

The APA Report should contain a vast amount of information on past APAs, including accepted transfer pricing methodologies, critical assumptions, criteria for selection of comparable companies and products, the nature of and mechanism for making adjustments, approaches for sharing currency risk, and other significant data. Although the information will not be taxpayer-specific, it should be a valuable resource for all multinational companies, whether or not they are currently participating in the APA Program.

Caplin & Drysdale can help you make sense of the APA Report. We have been in the forefront of U.S. transfer pricing law for many years, working with the IRS and foreign tax authorities. Even BNA's court filings described Caplin & Drysdale as "reknown[ed] for its APA practice." If you have questions about the APA Report or would like to discuss its impact on your business, please contact us.

Congress To Consider New Disclosures of Confidential Tax Information

Another important issue, the confidentiality of your tax return information, may be the subject of legislation in Congress this year. A recent Congressionally-mandated study by the Joint Committee on Taxation (JCT) recommends significant changes in the rules governing when such tax information should be publicly available. If the recommendations are enacted, confidential information that you provide to the IRS for tax purposes may increasingly become available to the public at large — including your competitors.

Access to tax return information is clearly on the minds of lawmakers. The JCT conducted its study in response to a requirement that Congress imposed in the IRS Restructuring and Reform Act of 1998. As discussed above in this Alert, just last year Congress passed several changes to the confidentiality provision of the Internal Revenue Code, section 6103, in order to protect information related to APAs. It acted in response to litigation initiated by BNA, in which the IRS had conceded the legal issues and was prepared to release all existing APAs. Caplin & Drysdale's action as *amicus curiae* paved the way for the legislation.

Congress appears poised to enact further amendments to section 6103 this year as a result of the JCT study. That study recommends several changes that may affect your business, including:

- Additional disclosure of rulings, internal legal advice, and other "working law" of the IRS. The scope of this proposal may be of particular interest as the restructured IRS expands the use of Pre-Filing Agreements in areas other than transfer pricing. *(See related article in this Alert.)*
- Changes in the disclosure regime under treaties and treaty exchange of information provisions. Such changes may affect the way the IRS works with other nations' tax administration agencies, and may also have an impact on your relationships with those agencies.
- New standards for processing the release of taxpayer information to third parties (and even competitors) in certain tax litigation.
- Revisions in the provisions allowing disclosure pursuant to taxpayer "consents." The use of such consents has become an all-purpose way around the Code's detailed restrictions on the disclosure of return information.

The Department of the Treasury is also due to release a study of section 6103 and confidentiality issues this spring. Like the JCT, Treasury is expected to recommend changes in the disclosure regime that may affect both domestic and multinational businesses.

Although it is always difficult to predict what Congress may do, particularly in a presidential election year, there is a good chance that changes in the Code's confidentiality and disclosure rules will be enacted if any tax legislation is passed this year. We will be monitoring the legislative situation as it develops. If you would like more information on this issue or on ways to ensure that your interests are protected, please contact us.