THE TEXAS TAX LAWYER

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THE CHAIR'S MESSAGE

By: John Brusniak, Jr.

I suppose it is redundant to call attention to the obvious, but given the fact that we are proud of the new format of our section newsletter, I will. The new format, coupled with the changing of the name of our publication to the TEXAS TAX LAWYER is our way of demonstrating our move into the new century. Additionally, the newsletter will be coordinating with its counterparts in other Tax Sections and will be sharing articles and ideas with them. So, be on the lookout for more timely and varied articles on matters of interest from writers from across the nation. At the same time, I invite you to submit articles for publication to the TEXAS TAX LAWYER with the understanding that your article may be picked up for national distribution as well.

We are currently working on setting up opportunities for members of our section to meet together with the Congressional leadership in Washington for open discussions on legislative issues. We also are working on setting up open channels of communication with our representatives, senators and national leaders and setting up additional opportunities for them to meet with us at our seminars and programs in Texas. We believe that such meetings, which would be open to our entire membership, will be beneficial to both us as tax practitioners as well as to our elected representatives. We ultimately hope to set up similar liaisons with our state legislators as well.

We are working on bringing younger and newer members into our sections. We urge you to get young lawyers to join our section and to become active in our committees. Such new membership will insure our viability long into the 21st Century. I would like to encourage you, if you have not already done so, to check out and sign up on our Section web site. It is located at http://www.texastaxsection.org/. The page is constantly evolving. Currently, there are numerous tax research articles from seminars and programs at your disposal, information on our committees and committee projects, calendars of upcoming continuing legal education programs and a bulletin board where you may post your questions for response by other members of the section. Clearly, the internet is the developing research tool of the future, and we intend to evolve and develop with it.

As officers of the section, we look forward to continuing to be of service to you. Please let us know how we can help you better over the coming years.

THE EDITOR'S MESSAGE

With the new millennium here, we've changed our name and looks. One thing, however, has not changed: we still need your articles. In connection with our new look, I want to extend a special thank you to Sean Sanderling and Willie Hornberger at Jackson & Walker in Dallas for the new cover design. They both did a great job.

Our next edition of the Texas Tax Lawyer will be published in May of 2000. The deadline for submitting articles to me for the May Texas Tax Lawyer is March 16. This March 16 deadline is critical for the May edition to go out timely. Finally, please take a look at the committee roster near the back of this edition. If you have not already done so, we would encourage you to sign-up for a committee and get involved with the Tax Section.

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CLE CALENDAR

- University of Miami School of Law 3rd Annual Institute on Tax Considerations in Mergers & Acquisitions, February 24 & 25, 2000 - Key Biscayne, FL - Sonesta Beach Resort

- State Bar of Texas Advanced Estate Planning Strategies Course 2000, April 27-28, 2000 - San Francisco, CA - Renaissance Stanford Court

- ABA Section of Taxation 2000 May Meeting, May 11-13, 2000 - Washington, D.C. - Grand Hyatt Hotel

- 16th Annual Federal Tax Institute, June 15, 2000 - San Diego, CA - Hyatt Hill Country Resort

PROPERTY TAX LAW DEVELOPMENTS

By: John Brusniak, Jr.[1]

UNITED STATES DISTRICT COURT

F.D.I.C./R.T.C. IS RESPONSIBLE FOR TAXES AND INTEREST WHICH ACCRUE ON PROPERTY WHILE IT IS IN THEIR POSSESSION; THEY ARE NOT RESPONSIBLE FOR PENALTIES; TRANSFEREE FROM F.D.I.C/R.T.C.. IS NOT RESPONSIBLE FOR TAXES, INTEREST OR PENALTIES DURING GOVERNMENT'S POSSESSION UNLESS THEY HAVE CONTRACTED OTHERWISE.

Travis County v. Resolution Trust Corp., 61 F.Supp.2d 581 (W.D. Tex. 1999).

Taxing units sued in federal court the Resolution Trust Corporation ("RTC'), the Federal Deposit Insurance Corporation ("FDIC") and the party who acquired certain properties from these governmental entities for tax delinquencies which arose during and after the government's ownership of the properties. The RTC/FDIC had acquired these properties as a receiver for a failed bank. The court ruled that the RTC/FDIC was responsible for the base tax which accrued during its ownership under FIRREA and that it was also responsible for the interest on those taxes as a matter of policy. It ruled however that the government was not responsible for any penalties due on those taxes due to its refusal to waive its sovereign immunity. It further ruled that the transferee from the government was not responsible for any of these costs unless it had specifically contracted with the RTC/FDIC to pay them. It ruled that the dispute pertaining to taxes, penalties and interest which arose after the transfer should be adjudicated in state court.

TEXAS COURTS OF APPEALS

TAXPAYER WHO CONTACTED TAX OFFICE PRIOR TO DELINQUENCY DATE INFORMING THE TAX OFFICE OF TAXPAYER'S INABILITY TO TIMELY PAY ITS TAXES AND WHO ENTERED INTO PAYMENT AGREEMENT AFTER DELINQUENCY DATE, AND KEPT AGREEMENT, WAS NOT BARRED FROM MAINTAINING PROPERTY TAX VALUATION SUIT; CONDUCT CONSTITUTED SUBSTANTIAL COMPLIANCE; FAILURE TO FILE AFFIDAVIT OF INABILITY WAS IRRELEVANT UNDER CIRCUMSTANCES.

J.C. Evans Construction Co., Inc. v. Travis Central Appraisal District, No. 03-98-00508-CV (Tex. App.–Austin, October 28, 1999, no pet. h.) (to be published).

Taxpayer filed valuation suit against appraisal district. Prior to the delinquency date, taxpayer contacted the taxing office informing them of its inability to timely pay its taxes and offering to pay them on an installment basis. Subsequent to the delinquency date, the taxpayer entered into a written installment payment agreement with the tax office and honored the agreement. Appraisal district moved to dismiss the suit due to the taxpayer's failure to pay its taxes timely and due to the taxpayer's failure to file an oath of inability to pay taxes. The court ruled that the taxpayer's conduct constituted substantial compliance with the statute and that the taxpayer's notification to the tax office of its inability to pay its taxes timely, coupled with the written installment agreement obviated the need for filing an oath of inability to pay. It further ruled that it could consider these circumstances in their totality in making a determination, and that the failure of the taxpayer to completely qualify under either alternative provision would not cause a dismissal of the suit.

PROPERTY TAX SUITS BY TAXPAYERS ARE DEFENSIVE IN NATURE; HENCE FOREIGN PARTNERSHIPS MAY DEFEND SUITS WITHOUT REGISTERING WITH SECRETARY OF STATE; UNDER PRIOR STATUTE, LESSEE COULD NOT REPRESENT PROPERTY WITHOUT FILING FIDUCIARY FORM; JURISDICTIONAL DEFECT IN FIRST YEAR OF LAWSUIT DOES NOT NEGATE SECOND YEAR IN CONTROVERSY; UNDERGROUND STORAGE CAVERNS ARE NOT IMPROVEMENTS AND MAY NOT BE ASSESSED SEPARATELY FROM LAND.

Harris County Appraisal District v. Coastal Liquids Transportation, L.P., No. 01-98-00017-CV (Tex.App.–Houston [1st Dist.] September 30, 1999, no. pet. h.) (to be published).

Taxpayer/lessee filed suit against appraisal district claiming multiple assessment of land and underground storage caverns. Appraisal district sought to have suit dismissed on the grounds that the taxpayer was a foreign limited partnership and had not registered with the Secretary of State's office. Suits by unregistered foreign partnerships are barred; however, foreign limited partnerships are allowed to defend against any actions, suits or proceedings brought against them. The court ruled that property tax appeal suits, which may be filed by taxpayers as plaintiffs, are in fact defensive in nature since the action is in fact a defense of a an assessment made by the chief appraiser; and hence, an unregistered foreign corporation is not barred from filing such a suit. Lessees, however, who had not filed fiduciary forms with the appraisal district (prior to the effective date of the statutory amendment authorizing lessees to file property tax protests and suits) did not have standing to act as the agent of the owner, nor could they file suits in their own names. Suits filed after the effective date of the amendment, could be brought in the lessee's name. Underground storage caverns may not be separately appraised from land, and any attempt to appraised them as improvements constitutes a multiple appraisal. A jurisdictional defect in the pleadings of a property tax suit which bars a cause of action as to the first year in controversy does not bar the subsequent years.

TAXING UNIT IS ONLY REQUIRED TO INCLUDE UNENCUMBERED FUND BALANCES IN AD VALOREM TAX ACCOUNTS IN ITS "TRUTH-IN-TAXATION" NOTICES; COMPTROLLER'S GUIDE DOES NOT HAVE THE STANDING OF LEGALLY PROMULGATED RULES, BUT WILL BE GIVEN CONSIDERATION IF IT IS REASONABLE AND CONSISTENT WITH LEGISLATIVE INTENT.

El Paso County Hospital District v. Gilbert, No. 08-98-00281-CV (Tex.App.–El Paso, September 16, 1999, pet. filed) (to be published).

Taxpayers filed suit seeking declaratory and injunctive relief contending that the taxing unit was violating the "truth-in-taxation" provisions by failing to publish information regarding all unencumbered fund balances. Taxing unit contended that the Truth-in-taxation guide published by the Comptroller's office did not require it to publish information regarding all unencumbered fund balances, only those in property tax accounts. The court ruled that the guide did not have the standing of legally promulgated rules, but that it should be given serious consideration if it was reasonable and consistent with legislative intent. The court further ruled that it was and that the taxing unit was only required to publish the unencumbered fund balances in its property tax accounts.

AN OVERRIDING ROYALTY INTEREST WHICH PRODUCES NO INCOME MAY BE VALIDLY APPRAISED AT NO VALUE BY AN APPRAISAL DISTRICT.

Destec Properties Limited Partnership v. Freestone Central Appraisal District, No 10-98-033-CV (Tex.App.–Waco, August 31, 1999, no pet. h.) (to be published).

Taxpayer owned an overriding royalty interest in a lignite mine; however, under the terms of its agreement it was required to pay over all overriding royalties to another owner of overriding royalties in the same mine. Taxpayer's principal interest in the property was in assuring itself of a continuing supply of lignite. As a result of these arrangements, the taxpayer derived no income from its overriding royalty interest. The court ruled that the income approach was the proper approach to be applied under this circumstance, and given the fact that the property produced no income, it was validly appraised at "zero" to this taxpayer. It distinguished this situation from those situations involving long term below market leases because these two interests were in a symbiotic relationship with each other and the full value was being assessed against the other overriding royalty.

PARTY MOVING SOME, BUT NOT ALL PERSONALTY OUT OF COUNTY, MAY NOT RETROACTIVELY CORRECT TAXATION OF ENTIRETY OF PROPERTY; COURT MAY NOT LOOK BEHIND APPRAISAL ROLL TO UNDERLYING DOCUMENTS TO DETERMINE WHETHER INCORRECT APPRAISAL OCCURRED.

Titanium Metals Corp. v. Dallas County Appraisal District, 3 S.W.3d 63 (Tex. App.–Dallas 1999, no pet. h.)

Taxpayer owned a facility which contained inventory, machinery and equipment in Dallas County. Prior January 1, the taxpayer relocated virtually all of its property outside of the county, leaving behind a small and simple sales office. Taxpayer erroneously rendered all of the property as being located in Dallas County. A year later, the taxpayer filed a motion for correction of the appraisal roll under Section 25.25(c)(3) contending that the property was not in the location shown on the appraisal roll. The court refused to correct the error ruling that it could correct errors in location only when there was no property remaining in the county. All other such claims were merely disputes over the valuation of the property which could not be addressed under this statute. It additionally ruled that it could not consider the erroneous rendition or the commercial worksheets because it was not allowed to look behind the appraisal roll in making its determination.

ATTORNEY GENERAL OPINIONS

CITY MAY NOT UTILIZE UNEXPENDED "TIF" ZONE FUNDS OUTSIDE OF ZONE UNLESS ZONE'S BOARD OF DIRECTORS AGREED TO SUCH EXPENDITURE IN ADVANCE.

Op. Tex. Att'y Gen. JC-0141 (1999).

The attorney general ruled that a city may not utilize unexpended monies following the termination of a tax increment financing reinvestment zone for other projects outside the boundaries of the zone, nor may it complete a reinvestment zone project in a manner which is inconsistent with the zone's board of director's plans. The city may undertake such projects if the zone's board of directors agreed to dedicate such revenue to replace areas of public assembly.

COUNTY TAX ASSESSOR MAY UTILIZE INTEREST EARNED ON MOTOR VEHICLE TAX TO SUPPLEMENT THE SALARIES OF HIS EMPLOYEES IF SUCH A DETERMINATION IS MADE PROSPECTIVELY AND IF IT IS A LEGITIMATE EXPENSE OF ADMINISTERING THE TAX; A COUNTY AUDITOR HAS THE RIGHT TO AUDIT HOW SUCH FUNDS ARE USED.

Op. Tex. Att'y Gen. JC-0135 (1999).

The attorney general ruled that a count tax assessor was entitled to utilize interest earned on collections of the motor vehicle tax to supplement the salaries of his employees who work on collecting the tax; however, the tax assessor was not allowed to give such employees bonuses out of these funds, but could only allocate the funds prospectively to cover the costs associated with collecting the tax. The attorney general further ruled that a county auditor had the right to audit the use of these funds to insure they were being properly applied.

TAXING UNIT MAY NOT WAIVE PENALTIES OR INTEREST ON DELINQUENT TAXES DUE ON PRIVATELY OWNED BUILDING LEASED TO NONPROFIT ORGANIZATION.

Op. Tex. Att'y Gen. JC-0134 (1999).

Private individual leased property to a nonprofit organization for its exempt use. Taxpayer mistakenly believed that such lease exempted the property from taxation, and hence did not pay the tax. County requested an opinion as to whether it could waive the penalties and interest due on the delinquent tax. The attorney general ruled that the penalties and interest could not be waived since the error was not caused by any governmental entity.

TAX ABATEMENT AGREEMENTS ENTERED INTO PRIOR TO SEPTEMBER 1, 1989 FOR PERIODS UP TO 15 YEARS MAY BE HONORED; AGREEMENTS MADE AFTER THAT DATE ARE LIMITED TO 10 YEARS; ONCE A 10 YEAR PERIOD HAS EXPIRED, AN ABATEMENT AGREEMENT MAY NOT BE RENEWED.

Op. Tex. Att'y Gen. JC-0133 (1999).

The attorney general ruled that tax abatement agreements which were executed prior to September 1, 1989 and which provided for abatement periods up to 15 years could be honored even though the legislature shortened the abatement period to 10 years. Agreements made after that date may not exceed a total of ten years, and such agreements may not be renewed for the same property even if the property is acquired by a new owner.

MOVING A STRUCTURE FROM ONE LOCATION TO ANOTHER ON A PIECE OF PROPERTY MAY POSSIBLY QUALIFY AS A REPAIR OR IMPROVEMENT UNDER THE PROPERTY REDEVELOPMENT AND TAX ABATEMENT ACT.

Op. Tex. Att'y Gen. JC-0106 (1999).

Under the Open Beaches Act, property owners are required to remove structures from public beaches. County wished to grant property tax abatements to these owners to encourage them to move the structures to new locations on their property. County queries the attorney general whether such an action would qualify for abatement under the Property Redevelopment and Tax Abatement Act. Without commenting directly on the facts of the particular case, the attorney general opined that moving a structure from one location to another on the same piece of property could in fact qualify as a repair or improvement for purposes of the Act.

COUNTY COMMISSIONERS ARE NOT AUTHORIZED TO PROVIDE DEVELOPMENT GRANTS TO PRIVATE PARTIES IN LIEU OF TAX ABATEMENTS.

Op. Tex. Att'y Gen. JC-0092 (1999).

County commissioners' court asked the attorney general whether it would be able to issue development grants in lieu of tax abatements under provisions of the Property Redevelopment and Tax Abatement Act and under the Local Government Code. The county claimed that these grants were authorized by Article III, section 52-a of the Texas Constitution. The attorney general disagreed, ruling that a county must have specific authority to conduct its business and that Article III, Section 52-a of the Texas Constitution was not self-executing. Since the legislature had not provided county governments with specific authority to issue such grants, the county could not do so in lieu of issuing tax abatements.

SALARY WARRANT MAY NOT BE ISSUED TO A JUSTICE OF THE PEACE AGAINST WHOM A DELINQUENT PROPERTY TAX JUDGMENT HAS BEEN ISSUED UNTIL THE JUSTICE OF THE PEACE PAYS THE JUDGMENT.

Op. Tex. Att'y Gen. JC-0087 (1999).

The attorney general ruled that under Section 154.025 of the Texas Local Government Code a county treasurer or auditor could not issue a salary warrant to a justice of the peace against whom an unpaid delinquent tax judgment existed. Warrants could be issued if taxes were merely delinquent because the claim could be deemed uncertain, but once a judgment had been entered the debt was deemed to be definitive.

ENDNOTES

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REGULATORY DEVELOPMENTS UNDER SUBCHAPTER C

Ronald D. Kerridge[1]

This article summarizes three of the significant sets of Proposed Regulations that the Treasury has issued during the past year under Subchapter C: (i) the "Anti-Morris Trust" regulations pursuant to Section 355(e), (ii) the regulations removing the *Bausch & Lomb* problem for C reorganizations, and (iii) the purchase price allocation regulations affecting Section 338 and Section 1060.

I. "Anti-Morris Trust" Regulations

A. Background

In 1997, Congress amended Section 355 of the Internal Revenue Code of 1986, as amended (the "Code"), by adding Section 355(e). Section 355(e) is aimed at preventing a tax-free spin-off followed by the acquisition of either the parent corporation ("Distributing") or the spun-off former subsidiary ("Controlled"). Congress perceived such transactions as violating the spirit of the repeal of General Utilities and undermining the integrity of the corporate tax.[2]

The leading case in this area is *Commissioner v. Mary Archer W. Morris Trust*, 367 F.2d 794 (4th Cir. 1966). In that case, Distributing owned a banking business and an insurance business. Distributing dropped the insurance business into Controlled and spun off Controlled to its shareholders. Then, pursuant to a prearranged plan, Distributing merged with another bank. At the end of the day, the shareholders of Distributing owned 54 percent of the resulting banking corporation. The Fourth Circuit concluded that the spin-off of Controlled was tax-free because preparing for the bank acquisition constituted a proper business purpose for the spin-off. The IRS acquiesced in *Morris Trust* (Rev. Rul. 68-603, 1968-2 C.B. 148), acknowledging that preparing for acquisition was a valid business purpose under Section 355. Over the years, the goal of deterring an acquisition also became a proper business purpose for a spin-off. (Rev. Proc. 96-30, 1996-1 C.B. 696.)

B. The Statute

Section 355(e) imposes corporate-level tax on Distributing in the case of any distribution of Controlled "which is part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation." Section 355(e)(2)(A)(ii).[3] Distributing is taxed as if it sold the stock of Controlled for its fair market value. Section 355(e)(1), (c)(2).[4] A 50 percent or greater interest means stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of all classes of stock. Section 355(e)(4)(A), (d)(4).

Section 355(e)(2)(B) creates a presumption that a plan exists if one or more persons directly or indirectly acquire stock representing a 50 percent or greater interest in the distributing or any controlled corporation during the four-year period that begins two years before the date of the distribution "unless it is established that the distribution and the acquisition are not pursuant to a plan or series of related transactions." Starting immediately upon enactment of Section 355(e), practitioner comments centered on what a "plan" meant for purposes of this provision: what was a plan, who had to have it, and how could the presumption of Section 355(e)(2)(B) be rebutted?

C. The Proposed Regulations

The Treasury responded by issuing proposed regulations (Prop. Reg. § 1.355-7) on August 19, 1999 that leave a number of issues under Section 355(e) unaddressed but do provide a considerable amount of guidance on the meaning of a plan and the operation of the presumption under Section 355(e)(2)(B). The essence of the proposed regulations is that they (i) provide a reasonable opportunity to rebut the presumption of a plan if both Distributing and Controlled strictly observe a six-month cooling-off period after the spin-off but (ii) make the presumption practically impossible to rebut if "substantial negotiations concerning the acquisition" occur prior to the spin-off or within six months thereafter.

1. The General Rebuttal

If an acquisition of Distributing or Controlled occurs within two years of the spin-off, the proposed regulations provide two ways to rebut the resulting presumption that the spin-off and the acquisition are part of a plan (or series of related transactions): the "general rebuttal" and the "alternative rebuttal." For the general rebuttal to apply, Distributing must establish by clear and convincing evidence that:

(1) the spin-off "was motivated in whole or substantial part by a corporate business purpose within the meaning of § 1.355-2(b) (other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired)" and

(2) the acquisition occurred more than 6 months after the spin-off and "there was no agreement, understanding, arrangement or substantial negotiations concerning the acquisition at the time of the distribution or within 6 months thereafter." Prop. Reg. § 1.355-7(a)(2)(ii)(A).

The proposed regulations go on to state that the intent of Distributing, Controlled or the controlling shareholders of either Distributing or Controlled to facilitate an acquisition or decrease the likelihood of an acquisition is relevant to determining whether the spin-off was motivated in substantial part by another valid Section 355 business purpose. The examples in the proposed regulations set out this proposition more strongly. An acquisition-related intent "is a factor tending to disprove" that the spin-off was motivated by another proper business purpose. Prop. Reg. § 1.355-7(a)(8), ex. (3). Phil Levine, IRS assistant chief counsel (corporate), offered a gloss on this weighing of business purposes at the Practicing Law Institute session on October 14, 1999. Whether the non-acquisition purpose is substantial enough turns on the question, "would you have done the spin-off without the acquisition-related purpose? It's a causality question."[5]

The other major question under the general rebuttal is what constitutes an agreement, understanding, arrangement or substantial negotiations concerning the acquisition. The proposed regulations make it clear that there need not be a binding agreement or agreement on all terms in order to have an agreement, understanding or arrangement. Prop. Reg. § 1.355-7(a)(5). Further, the preamble to the proposed regulations[6] makes clear that Section 355(e) can apply to a post-spin-off public offering and "other transactions that are economically similar," including a private placement of Distributing or Controlled stock or an auction of such stock by an investment banker.

In light of the foregoing, the preamble explains:

> "Under certain circumstances, such as in public offerings or auctions of the distributing or controlled corporation's stock by an investment banker, an agreement, understanding, arrangement, or substantial negotiations can take place regarding an acquisition even if the acquiror has not been specifically identified. The Department of the Treasury and the IRS are particularly interested in receiving comments regarding transactions that involve an investment banker and when contacts by the distributing corporation or the controlled corporation with an investment banker or contacts with potential acquirors by an investment banker on behalf of the distributing corporation or the controlled corporation should or should not be considered an agreement, understanding, arrangement, or substantial negotiations."[7]

As Karen Gilbreath, an attorney-advisor in Treasury's office of Tax Legislative Counsel, said at the PLI seminar, "You just need to keep your hands clean for six months."[8] Clean appears to mean spotless.

2. The Alternative Rebuttal

If an acquisition of Distributing or Controlled occurs within two years of the spin-off and Distributing cannot avail itself of the general rebuttal (either because of the absence or weakness of its non-acquisition business purpose or because of some prohibited activity during the six-month window), Distributing faces the daunting task of trying to use the alternative rebuttal.[9] For the alternative rebuttal to apply, Distributing must establish by clear and convincing evidence all three prongs of a three-prong test:

> (1) Either (i) at the time of the spin-off, Distributing, Controlled and their controlling shareholders did not intend that one or more persons would acquire a 50-percent or greater interest in Distributing or Controlled during the statutory pre-

sumption period, or (ii) the spin-off was not motivated in whole or substantial part by an intention to facilitate an acquisition of an interest in Distributing or Controlled;

(2) At the time of the spin-off, neither Distributing, Controlled nor their controlling shareholders reasonably would have anticipated that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in Distributing or Controlled within two years after the spin-off (or later pursuant to an agreement, understanding, or arrangement existing at the time of the spin-off or within 6 months thereafter) who would not have acquired such interests if the spin-off had not occurred; and

(3) The spin-off was not motivated in whole or substantial part by an intention to decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired. Prop. Reg. § 1.355-7(a)(2)(iii).

The second prong of the alternative rebuttal - what the preamble calls the "reasonable anticipation" test[10] - will be extremely difficult to satisfy. The proposed regulations give one example in which Distributing is able to use the alternative rebuttal. The example recites that, at the time of the spin-off, neither Distributing, Controlled, nor their controlling shareholders would reasonably anticipate that it was more likely than not that one or more persons would acquire a 50-percent interest in Distributing or Controlled within two years. Two months after the spin-off, Controlled "is approached unexpectedly about an opportunity to acquire X," and three months later Controlled acquires X for Controlled stock. Prop. Reg. § 1.355-7(a)(8), ex. (9). What the example does not say is how Distributing musters clear and convincing evidence to carry the burden of showing the absence of a reasonable anticipation about what is more likely than not, wholly apart from how Distributing demonstrates that the overture from X was unexpected.[11]

3. Acquisitions More Than Two Years After the Spin-off

If more than two years pass after the spin-off before an acquisition of more than 50 percent of Distributing or Controlled, the presumption shifts to the taxpayer's favor. The spin-off and the acquisition will only be presumed to be part of a plan if there was an agreement, understanding, or arrangement concerning the acquisition at the time of the spin-off or within two years thereafter. Distributing may rebut such a presumption using either the general rebuttal or the alternative rebuttal. Prop. Reg. § 1.355-7(a)(3). So even with a two-year wait for closing, if the IRS can show an agreement, understanding, or arrangement prior to the end of the two years, the taxpayer will be held to having a substantial non-acquisition business purpose and six months of clean hands following the spin-off.

4. Treatment of Options

Options to acquire stock of Distributing or Controlled are presumptively treated as agreements to acquire stock. If stock is acquired pursuant to an option, the option is treated as an agreement unless Distributing establishes by clear and convincing evidence that, on the later of the date of the spin-off or the date of the issuance of the option, the option was not more likely than not to be exercised. Prop. Reg. § 1.355-7(a)(7)(i)(A). Under various circumstances, agreements, understandings, or substantial negotiations concerning the issuance of an option can cause the option to be treated as having been issued before its actual issuance. Prop. Reg. § 1.355-7(a)(7)(i)(B). Certain compensatory options, security agreements, and other options are ignored unless they have a principal purpose of avoiding the application of Section 355(e) or the options rules contained in the proposed regulations. Prop. Reg. § 1.355-7(a)(7)(iii).

5. Spin-off of Multiple Controlleds, Not All of Which Are Acquired

If Distributing spins off more than one Controlled, Distributing is not acquired thereafter and one or more but fewer than all Controlleds are acquired, the proposed regulations provide that Distributing will recognize gain only on the stock of the Controlled(s) that are subsequently acquired. Prop. Reg. § 1.355-7(b).

II. Liberalization of C Reorganization Rules

A. Background

Section 368(a)(1)(C) provides tax-free reorganization treatment to the acquisition by one corporation of all or substantially all of the assets of another corporation in exchange solely for voting stock of the acquiring corporation or its parent. Notwithstanding the initial statement that the consideration must be solely voting stock, the use of money or property other than voting stock of the acquiror or its parent is permitted if at least 80 percent of the gross fair market value of the target's assets is acquired for voting stock. Section 368(a)(2)(B); Reg. § 1.368-2(d). This rule, generally referred to as the "boot relaxation rule," effectively treats the assumption of target liabilities (including liabilities subject to which the target's assets are taken) as payment of boot for purposes of the 80 percent-of-gross-value test.

In 1954, the IRS issued a revenue ruling that made C reorganizations unavailable if the acquiring corporation owned more than 20 percent of the target's stock prior to the transaction. In Rev. Rul. 54-396, 1954-2 C.B. 147, a corporation had acquired 79 percent of the stock of another corporation in a cash purchase. Subsequently, in an unrelated transaction, the parent transferred its own voting stock to the 79-percent-owned subsidiary in exchange for the subsidiary's assets. The subsidiary liquidated and distributed the parent stock pro rata to the 21 percent minority and back to the parent. The IRS ruled that this transaction failed as a C reorganization because the parent acquired 79 percent of the target's assets in exchange for the stock in target that the parent already held. Under this analysis, the "solely for voting stock" rule was violated, since more than 20 percent of the target's assets were acquired for consideration other than voting stock of the parent. The IRS prevailed in this interpretation on virtually identical facts in *Bausch & Lomb Optical Co. v. Commissioner*, 30 T.C. 602 (1958), *aff'd*, 267 F. 2d 75 (2nd Cir.), *cert. den.*, 361 U.S. 835 (1959).

Taxpayers found ways to avoid the *Bausch & Lomb* problem, and the IRS blessed several of these solutions. An upstream A reorganization works on *Bausch & Lomb* facts. Rev. Rul. 58-93, 1958-1 C.B. 188. So does a subsidiary C reorganization (Rev. Rul. 57-278, 1957-1 C.B. 124), a forward triangular merger under Section 368(a)(2)(D) (PLR 9049050 among others), and a reverse triangular merger under Section 368(a)(2)(E) (PLR 8514079). The *Bausch & Lomb* doctrine remained important only as a trap for the unwary or when non-tax considerations made all the other approaches to the issue unfeasible.

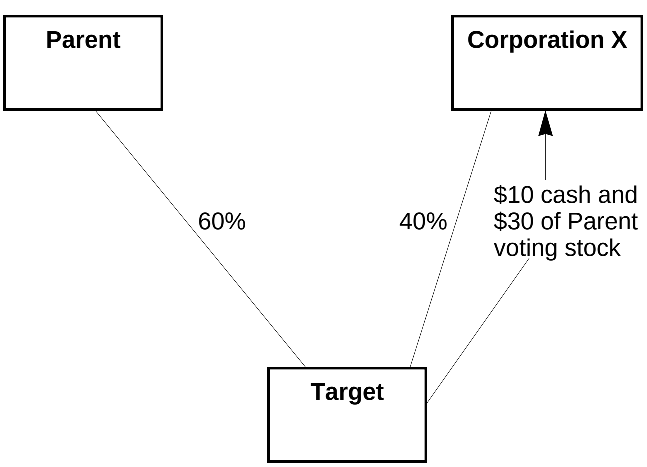
B. The Proposed Regulations

On June 11, 1999, the Treasury issued proposed regulations reversing the Government's position on C reorganizations involving partially owned subsidiaries. Provided that the parent's ownership of stock in the target is old and cold, the portion of the target's assets corresponding to the parent's ownership of target stock will be treated as if it had been acquired for parent voting stock for purposes of the boot relaxation rule.

The preamble to the proposed regulations explains the Government's change of heart as follows:

> "The legislative history of the "C" reorganization provisions provides that the purpose of the solely for voting stock requirement in section 368(a)(1)(C) is to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations. The IRS and Treasury Department have concluded that a transaction in which the acquiring corporation converts an indirect interest in assets to a direct interest in those assets does not resemble a sale and, thus, have concluded that Congress did not intend to disqualify a transaction from qualifying under section 368(a)(1)(C) merely because the acquiring corporation has prior ownership of a portion of a target corporation's stock. Because the judicial doctrine of continuity of interest arose from similar concerns, the regulations under section 1.368-1(e)(1)(i) reach a similar conclusion with respect to the continuity of interest doctrine."

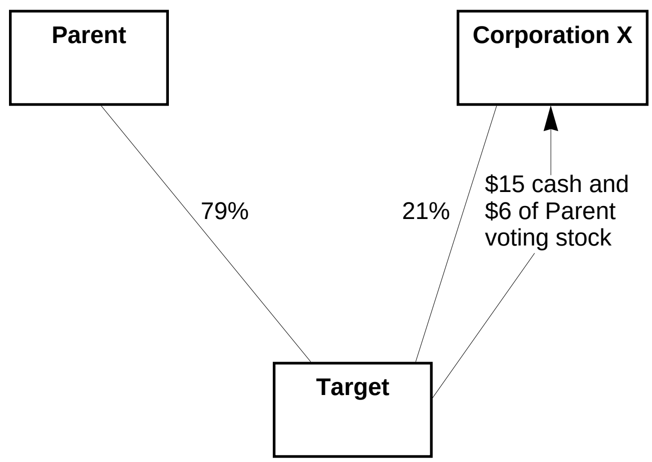
The proposed regulations illustrate the application of this analysis with an intriguing example (Prop. Reg. § 1.368-2(d)(4)(ii), ex. (1)):



The example assumes that Target has properties with a fair market value of $110 and liabilities of $10. The example states that Target transfers all its assets to Parent and, in exchange, Parent assumes Target's $10 of liabilities and transfers to Target $10 cash and $30 worth of Parent voting stock. Target distributes this Parent stock and $10 cash to X and liquidates. This transaction satisfies the solely for voting stock requirement because the sum of the assumed liabilities ($10) and the cash distributed to X ($10) does not exceed 20 percent of the gross value of Target's assets.

The writers of the proposed regulations presumably chose this example to show that they really believe the continuity of interest analysis set out in the preamble. More than 20 percent ($10 of $40) of the consideration received by X is cash. Therefore, if the Parent side of the transaction were deemed to mirror the X side ($15 cash out of $60 total), the transaction would not be a good C reorganization because $25 of cash plus $10 of assumed liabilities would exceed 20 percent of the $110 in Target gross asset value.

How far does this analysis carry? Suppose the following:



Assume that Target has properties with a fair market value of $104 and liabilities of $4. Under the analysis of the proposed regulations, the solely for voting stock requirement would be satisfied, because $15 of cash plus $4 of assumed liabilities does not exceed 20 percent of the $104 in gross value of Target's properties. But what about general continuity of interest rules? The only consideration actually paid out is 71.4% cash and 28.6% stock. General Counsel Memorandum 39404 (4/15/82) and Reg. § 1.368-1(e)(6) confirm that this transaction satisfies the continuity of interest requirement because Parent's old and cold ownership of Target stock counts on the right side of the continuity fraction.

C. Effective Date of the Proposed Regulations

The only controversy concerning the well received proposed regulations is the effective date, which the proposed regulations state will be the date of promulgation of these regulations as final. David Glickman of Baker & McKenzie argued that, because the proposed regulations are interpretative rather than legislative, and the *Bausch & Lomb* doctrine is a trap for the unwary, the new regulations should have retroactive effect, allowing taxpayers to elect to have the new rules apply.[12] Mr. Glickman basically got his wish. On December 21, 1999, the IRS released Notice 2000-1, stating that the Proposed Regulations, when finalized, would be modified to apply to transactions occurring after December 31, 1999. Also, taxpayers will be able to request private letter rulings permitting them to apply the regulation to transactions occurring on or after June 11, 1999.

III. Purchase Price Allocation Regulations

A. Background

In 1982, Congress enacted Section 338, allowing qualified stock purchases to be treated as asset sales for federal income tax purposes. Section 1060 was added by the Tax Reform Act of 1986, requiring both the buyer and the seller of a trade or business to allocate their consideration paid or received among the assets transferred using the same residual method required under Section 338. The Treasury and the IRS first issued temporary regulations under Section 338 in 1984. Since that time, they have promulgated a long list of regulations under both Section 338 and Section 1060, resulting in a poorly organized patchwork of rules that, in certain key areas, lacked a clear conceptual basis.

Briefly, Section 338 allows an acquiring corporation to elect to treat a stock acquisition as an asset acquisition if the buyer purchases 80 percent of the total voting power and 80 percent of the total value of the stock of the target corporation within a 12-month period. If the buyer makes a Section 338 election, the target is treated as if it (as old target) sold all of its assets at the close of the acquisition date at fair market value and (as new target) purchased all of the assets as of the beginning of the day after the acquisition date. This is a Section 338(g) election, often referred to as a "regular" Section 338 election. Because the buyer has acquired the target, this election has the effect of allowing the buyer to step up the basis of the target's assets, but at the cost - to the buyer - of having taxable income in the amount of the unrealized gain on target's assets.

A Section 338(h)(10) election, by contrast, causes the built-in gain to be taxed on the seller side of the transaction. Only a selling corporation that is a member of an affiliated group or an S corporation is eligible for a Section 338(h)(10) election, and the selling shareholders have to join the buyer in making the election. The old target is deemed (i) to sell all its assets while a member of the selling consolidated group (or, if applicable, while a non-consolidated affiliate or an S corporation) and (ii) immediately thereafter to liquidate and distribute the sales proceeds to its shareholder(s). Consequently, the selling shareholders realize gain or loss, if any, on their stock in the deemed liquidation.

B. The Proposed Regulations

In early August 1999, the Treasury and the IRS issued comprehensive proposed regulations under Section 338 and Section 1060 that seek to organize and rationalize these rules, fixing several problems that had troubled practitioners, attempting to bring these rules closer to the rules applicable to a literal asset purchase, and setting out a clear conceptual model of what happens when the parties make a Section 338(h)(10) election.

1. De-linking Old Target's and New Target's Accounting

The current regulations define both old target's amount realized from the sale of its assets (the "aggregate deemed sale price" or "ADSP") and new target's adjusted grossed-up basis in the assets it is deemed to purchase ("AGUB") with reference to (among other items) the purchaser's grossed-up basis in recently purchased target stock. This linkage does not exist in actual asset sales, where the timing and amount of the seller's amount realized and the buyer's basis may differ. The primary context in which the current regulations' linkage of ADSP and AGUB produces a different result from an actual asset sale is when there is contingent purchase price. In an actual asset sale, the seller is required to include the current fair market value of promised future contingent payments unless, in rare and extraordinary circumstances, the market value of the contingent payment obligation is not reasonably ascertainable. On the buyer's side, contingent payment obligations are added to the basis of the acquired assets only as and when the contingent payments are actually made. Reg. § 1.1012-1(g). By tying the ADSP to the AGUB, the current regulations effectively allowed sellers in the Section 338 context to have open-transaction treatment on contingent purchase price, which is inconsistent with Reg. § 1.1001-1(g)(2). The proposed regulations break the link between ADSP and AGUB, tying ADSP instead to the amount realized as if old target were itself the selling shareholder.

2. Using the Installment Method With a Section 338(h)(10) Election

Under the current regulations, there are no provisions allowing installment sale treatment to be combined with a Section 338(h)(10) election. Commentators have agreed that there is no conceptual or policy reason why these two should not be compatible, given that an actual asset sale could be structured to qualify for installment-sale treatment. Technical hurdles have caused commentators and practitioners to conclude that, under the existing regulations, installment sale treatment cannot be combined with a Section 338(h)(10) election. The proposed regulations fix this problem by allowing installment reporting in the context of a Section 338(h)(10) election as long as the other requirements for installment-sale treatment are met. In light of the statutory repeal of the installment method for accrual method taxpayers, this change will help only S corporations that are eligible for, and continue to use, the cash method.

3. Changes to Asset Allocation Classes

Section 338 and Section 1060 require that the purchase price on the deemed asset purchase be allocated, by both buyer and seller, using the residual method and five different asset classes. Purchase price is allocated starting with the first class and waterfalling down the remaining classes (based on the fair market value of all the assets in each class), with any remaining purchase price allocated to the final class. The current five classes are:

Class I	Cash and cash equivalents
Class II	Certificates of deposit, U.S. government securities, readily marketable stock or securities, and foreign currency

Class III	Everything not in another class
Class IV	§ 197 intangibles other than goodwill and going concern value
Class V	§ 197 intangibles in the nature of goodwill and going concern value

Particularly in the context of an acquisition involving the assumption of contingent liabilities, the buyer may run out of purchase price to allocate to the basis of the acquired assets before allocating full basis to the Class III assets. In this situation, the buyer must allocate basis among the Class III assets based on their relative fair market values. The result is that the buyer has less than full basis in some assets that turn into cash - and thus produce gain - relatively quickly, such as accounts receivable and inventory ("fast pay assets").

The proposed regulations fix the fast-pay asset problem by moving to the following seven asset classes:

Class I	Cash and cash equivalents
Class II	Certificates of deposit, U.S. government securities, actively traded personal property as defined in Section 1092(d), and foreign currency
Class III	Accounts receivable, mortgages, and credit card receivables that arise in the ordinary course of business
Class IV	Stock in trade of the taxpayer or other property of a kind that would properly be included in the inventory of taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business
Class V	Everything not in another class
Class VI	§ 197 intangibles other than goodwill and going concern value
Class VII	Goodwill and going concern value

4. Model of Section 338(h)(10) Election

The model on which taxation of a Section 338(h)(10) election is based that the proposed regulations set out is not surprising or ground-breaking. Under the proposed regulations, old target is treated as transferring all of its assets by sale to an unrelated person. Old target recognizes the deemed sale gain while a member of the selling consolidated group (or as an affiliated corporation or as an S corporation). Old target is then treated as liquidating and distributing the sales proceeds to its shareholder(s). The proposed regulations come as close as possible to treating all parties as if the steps that are deemed to have occurred under the Section 338(h)(10) election had in fact occurred. Additionally, the proposed regulations provide that the old target may not obtain any tax benefit from the Section 338(h)(10) election that it would not obtain if it actually sold its assets and liquidated.

5. Final Regulations

Victor Penico, IRS assistant chief counsel (corporate) and branch chief of branch 3, said on October 12, 1999, that the IRS hopes to finalize these regulations in early January 2000 and that the comments received by that date had not caused the Treasury and the IRS to reconsider any of the major policy decisions reflected in the proposed regulations.[13] The Service delivered on that prediction, issuing temporary regulations on January 7, 2000 without major changes.

ENDNOTES

1. Ronald D. Kerridge is an attorney with Hughes & Luce, L.L.P., 1717 Main Street, Suite 2800, Dallas, Texas 75201, (214) 939-5500, (214) 939-6100; (214) 939-5849 fax.
2. "In cases in which it is intended that new shareholders will acquire ownership of a business in connection with a spin-off, the transaction more closely resembles a corporate level disposition of the portion of the business that is acquired." S. Rep. No. 105-33, at 139-40 (1997).
3. Interestingly, Section 355(e) does not apply to the *Morris Trust* fact pattern, because the shareholders of Distributing in that case owned more than 50 percent of the stock of the combined banking entity.
4. It is noteworthy that the tax is on the built-in gain in Controlled's stock, regardless of whether it is Distributing or Controlled that is subsequently acquired. Consequently, it is desirable for the business with the smallest amount of appreciation to be spun off because of the risk that a post-spin transaction could trigger tax under Section 355(e).
5. Quoted in Lee Sheppard's "More Whining About the Proposed Anti-Morris Trust Rules," Tax Notes Today, October 22, 1999 (Doc. 1999-34438).
6. Fed Reg. Vol. 64, no.163, p. 46155 et seq.
7. Query whether contacts during the six-month period that do not lead to an acquisition would nevertheless make the general rebuttal unavailable for an acquisition within two years pursuant to contacts initiated in the eighth month after the spin-off.
8. Quoted in Lee Sheppard's article cited in note 4 *supra*.
9. The preamble explains that, if the general rebuttal cannot be satisfied, the 'circumstances [are] more likely to indicate a the existence of a plan at the time of the distribution. Thus, these acquisitions are subject to heightened scrutiny and will be considered part of a plan unless taxpayers satisfy a more stringent alternative rebuttal."
10. The preamble explains as follows. 'A reasonable anticipation standard is necessary to implement section 355(e). Otherwise, a distributing corporation could attempt to avoid section 355(e) by distributing a controlled corporation under circumstances that virtually assure an acquisition of the distributing or controlled corporation, but arguing that, despite the imminence of the acquisition, effectuating the acquisition was not a motive for the distribution. A part of planning any transaction includes attempting to foresee actions others might take in response. Consistent with this business practice, it is appropriate, especially for acquisitions subject to heightened scrutiny, to require the distributing corporation to take into account the reasonably anticipated, likely actions of others to demonstrate that a distribution and acquisition are not part of a plan."
11. Especially in light of the prescience that the preamble seems to attribute to Distributing; see note 9 *supra*.
12. "Attorneys Seek Changes to Proposed "C" Reorganization Regs," Tax Notes Today, September 11, 1999 (Doc. 1999-30653).
13. "Expect Final Asset Acquisitions Regs in January, Without Major Changes, IRS Officials Say," Tax Notes Today, October 12, 1999 (Doc. 1999-33069).

SO YOUR COMPANY OR YOUR CORPORATE CLIENT HAS BEEN SELECTED FOR A LARGE CASE EXAMINATION BY THE IRS, WHAT SHOULD YOU DO?

Martin M. Van Brauman[1]

Introduction

Participation is the operative strategy during an I.R.S. examination. To produce the optimum results with the least cost and burden, active participation in the audit process through the entire life cycle of the audit is critical. Such participation can influence the cycle size, the number of years examined and the timing and extent of the audit team on site. A mutually agreeable time period from the start of the examination to the completion needs to be established. Knowledge of what issues the exam team is going to pursue will enable a prioritization of those issues based upon the optimum time to have each issue developed. There must be a definite focus on information flow, in which all requests from the Internal Revenue Service (the "Service") are coming to a designated person for the taxpayer and all responses are coming from the same designated person.

Active participation is needed in the examination plan. The I.R.S. case manager's handbook allows for the taxpayer to play an active role in developing the examination plan. Under the handbook, the taxpayer should participate in developing the examination plan and should have access to all parts of the plan. An audit can be divided into six phases: preparing for an audit, the opening conference, the Information Document Requests (or "IDR") review, the interim cycle review, the closing conference and the post-examination critique.

Preparation Prior to the Exam

The preparation for an audit takes place prior to filing the tax return. The preparation process should take place as transactions occur throughout the year. A taxpayer must consider how a particular transaction might be treated by the Service and he should review the available records. The best records that a taxpayer will have to support his position are the available records at the time of the transaction. A file should be built to support the position that will be taken on the tax return. Files should be maintained with an audit in mind and with the ultimate outcome anticipated.

The pre-filing determination ("PFD") is a method of avoiding a future audit dispute over a particular transaction. Under IRM 42(11)8 §§ (14)50, 52, 53 and 55, pre-filing determinations provide an opportunity for the Service and the taxpayer to agree on the treatment of completed transactions prior to the filing of the tax return. If an examination team is performing an examination already, they would conduct the PFD for the tax returns for a future audit cycle.

A PFD situation occurs when a taxpayer has entered into a significant transaction, the transaction is completed, the taxpayer wants to take a particular position on the reporting of the transaction on his tax return, but he wants to resolve how the transaction should be reported and eliminate in the future any potential tax liability. The taxpayer submits a PFD request in writing to the District Director's office. The taxpayer would request a conference with the case manager after an agreement has been reached on the appropriateness of a PFD.

The issue is examined, reviewed by an audit team, and a determination is issued by the District Director on the proper reporting procedures for that transaction. The determination is followed by the Service, when the tax return is filed. If it is unfavorable to the taxpayer and he chooses not to follow it, he would report the transaction as he deems appropriate and make the appropriate disclosures.

In preparing for the actual audit, the taxpayer should obtain the industry specialization position ("ISP") papers. There are ISP papers on 40 different industries. The taxpayer should review the ISP for his industry prior to any audit. Also, the taxpayer needs to review other industry ISPs, since there may be an issue that could relate to his tax situation.

A taxpayer must review the examination issues and positions the Service took in prior audit years. The agents will reexamine the previous audit years to look for carryover issues. If there are issues the taxpayer settled in Appeals, he can raise Delegation Order 236 (Revision 3), providing authority to case managers to resolve certain issues previously settled by Appeals at the examination level.

The agents are going to make inquiries about all capital structure changes, acquisitions, liquidations, and reorganizations. The taxpayer should make sure that the files, supporting the treatment taken on the tax returns as a result of the transactions, are properly documented to satisfy the position taken on the returns. Every time the taxpayer reviews a file, as the transaction is being completed, he needs to review with an audit in mind.

Opening Conference

Prior to the opening conference, the IRS may issue some IDRs after preliminary discussions on the years to be examined. Initially, they are seeking general information, such as copies of tax returns, documents on any mergers or acquisitions, tax return work papers, internal audit reports, corporate minutes and stockholder and SEC reports.

During the opening conference, the taxpayer needs to set the tone for the audit and have a plan with objectives. The Service will have its initial plan. The taxpayer should insist that the Service bring, not only the revenue agents and specialists who are going to work the case, but also the case manager and branch chief. There must be an agreement on how problems will be resolved up to the branch chief level.

There are three parts to the initial examination plan of the Service. A taxpayer should request all three at the opening conference and set a date when he is going to receive the entire plan. The taxpayer needs to participate in the development of the final audit plan. The CEP program coordinator and the designated officer of the taxpayer will execute the final examination plan sometime after the opening conference and before the first interim cycle review.

A mutual understanding of the taxpayer's system and of the Service's process and priorities must be established. The taxpayer needs to know the Service's resources with respect to who is going to work the audit, what specialists will the Service use and what areas are they going to review. The taxpayer should try to establish the time frames.

The taxpayer needs to establish a communication plan. If there is a breakdown at the agent level, he must be able to quickly go to the case manager. If the case manager and the taxpayer have a breakdown, the taxpayer needs to be able to move the problem up the chain of authority. Thus, it is important for the I.R.S. management up to the branch chief level to be present at the opening conference. The taxpayer must establish prompt procedures to resolve problems.

The taxpayer must review any prior examination and post-examination critiques. He needs to communicate with the case manager any previous problems with the last audit team and solutions on preventing future problems. Hopefully, the taxpayer and the Service can systematize a more efficient and prompt determination process than in the past. Although the taxpayer will want to establish a final completion date, he needs to establish a series of dates when specific actions are to be completed. A series of deadlines allows for a more efficient monitoring of progress and feedback.

The taxpayer needs to prioritize the proposed issues in the audit. If there are two or three primary issues that, if resolved, would most likely lead to an agreed case, the taxpayer may want these issues audited first for the early referral process. Early referral is available under I.R.C. §7123(a) with the Form 5701 ("Notice of Proposed Adjustment") from the Examination division. The taxpayer is able to refer the issues to Appeals and avoid "hot" interest running under I.R.C. §6621(c), in which large corporate underpayments begin 30 days after the 30-day letter or the statutory notice of deficiency (90-day letter).

Early referral allows developed unagreed issues under the Examination division to be considered by Appeals prior to issuance of the 30-day letter or 90-day letter. See Rev. Proc. 99-28, 1999-29 I.R.B. 109, Sec. 2. With Form 5701, a taxpayer can request that these issues be placed under Appeals jurisdiction without the necessity of a 30-day letter. This procedure is optional and must be initiated by the taxpayer. The Assistant District Director and the Assistant Regional Director of Appeals (Large Case) must approve the use of this procedure. Thus, the taxpayer should discuss issues appropriate for early referral at the opening conference, so that they can be examined early in the process.

A taxpayer needs to be prepared for the Service's use of specialists on the Exam team. It is important to know who they are and what issues are being reviewed. They will have initial examination plans with specific issues, which a taxpayer should request. Another area of concern is the use of District Counsel by the I.R.S. Examination team. Usually, District Counsel has assigned an attorney to the large case team. A taxpayer should request to know who is the person.

A taxpayer should go to the opening conference with his own plan for the issues that are going to be presented and how the audit should be conducted. If a taxpayer has issues that he has not been able to influence during any development of the Examination plan, he should make sure that those issues are discussed during the opening conference.

IDR Review

During the opening conference, a taxpayer needs to discuss IDR procedures. Under field guidelines, IDRs should be discussed with the taxpayer prior to being issued. A taxpayer should discuss with the I.R.S. team coordinator before an IDR is drafted what question the team coordinator or the audit team is trying to answer. Through those discussions, a taxpayer may be able to answer that question and eliminate the need for the IDR, or determine the kind of available data for resolution of the issue. It may not be the data that the Exam team thought they wanted to obtain, or it may be much more limited. Thus, a taxpayer must take an active role in managing the requests and avoiding miscommunications and a breakdown in the audit process. Miscommunications could result in unnecessary and expensive formal document requests and summonses, if the Service believes that the taxpayer is nonresponsive to the informal requests for information and documents.

The taxpayer should consider what issue prompted each IDR and whether the requested information will answer that issue. The taxpayer should limit the scope of the IDR to the issue and object to shotgun IDRs. A taxpayer must ensure that all IDRs are coming from the I.R.S. team coordinator and that the team coordinator has had a discussion with the taxpayer's designated person. Only after that discussion has taken place and an agreement on the data to be provided has been reached, should the team coordinator sign the information document request.

If the Service is asking for testimony of a taxpayer's employee, it is critical that the taxpayer receives first a copy of the questions to be asked of the employee. A taxpayer should receive those questions in writing and respond to them in writing. If a taxpayer is unable to adequately respond to the questions in writing, only then would he want to consider making an employee available to provide oral testimony. If an employee is made available for oral testimony, the taxpayer needs to ensure that the person is properly prepared for that interview and the taxpayer's representative is an active participant in the testimony process.

It is important for the taxpayer to develop an IDR log, so that IDRs are recorded as of the date received and of the date of response. The taxpayer needs to verify that everything provided to the Service is reviewed, so that a taxpayer knows what may be embedded in those documents. A taxpayer must maintain copies of everything provided to the Service and number each page for proper tracking.

The taxpayer should insist that each IDR pertain to a specific request for a particular document and should not accept an IDR that represents multiple documents, or issues. It is important to maintain an IDR track record of the received dates and the respond dates, since the Service is maintaining a record of IDR response behavior in case of future summons enforcement actions. When a multiple document request or multiple issue request is received, it may be difficult to complete in its entirety with the possibility of something always open for question.

A taxpayer should meet with the Examination team at least monthly to go over the current status of all outstanding IDRs. With the Exam team, a taxpayer needs to summarize the number of IDRs received, the number of IDRs closed, and the number of IDRs still outstanding and their anticipated resolution. Some IDRs may be never resolved, if the taxpayer can never obtain this information, the information does not exist, or the taxpayer does not know where the information is located. It is not the taxpayer's responsibility to create records in response to IDRs, only to provide records that are within his control. If a taxpayer receives an IDR that he can not respond to, he should inform the IRS team coordinator. During each IDR review session, the taxpayer should discuss future IDRs with the team coordinator. He should ask how many do they anticipate issuing and what areas do they anticipate pursuing within the examination plan.

One area to discuss during the opening conference, is the involvement of District Counsel in the examination. Usually, District Counsel will be involved in the Coordinated Examination Program audits ("CPE examinations"). A taxpayer should request the team coordinator to notify him as soon as Exam is asking questions of District Counsel. The taxpayer should request the area of inquiry and the opportunity to provide to the team coordinator and District Counsel a statement of facts concerning that area of inquiry. Although the taxpayer does not have any right to be an active participant in the discussions between the audit team and the Counsel attorneys, he should request an opportunity to participate as actively as he can. It is important for a taxpayer to make sure that District Counsel and the audit team are fully aware of the facts as the taxpayer sees them.

Under I.R.C. § 7602(c), the Service must provide notice of contact with 3rd parties. The Service must give taxpayers a general warning at the beginning of the examination process that the Service might contact 3rd parties about the taxpayer. The Service must keep track of the 3rd parties who are contacted and must provide that information periodically to the taxpayer as well as be prepared to release it whenever the taxpayer may ask. At the opening conference, a taxpayer should ask about any 3rd parties that are expected to be contacted and any competent authority treaty requests contemplated for taxpayer information on cross-border issues. A taxpayer should actively participate in any foreign country's competent authority meetings with the Service.

Generally, I.R.C. § 7612 prohibits the issuance of a summons for tax related computer software source codes. This prohibition does not apply to tax-related computer software source code developed by the taxpayer for internal use rather than for commercial distribution, or to communications between the owner of the source code and the taxpayer or related person, or to any source code which is required to be provided or made available pursuant to any other provision of the Code.

There are conditions under which a summons for source codes may be issued. The statutory requirements are that (1) the Service is unable to reasonably ascertain the correctness of any item on a return from the taxpayer's books and records or the software program and associated data, (2) the Service identifies with reasonable specificity the portion of the source code needed to verify the correctness of an item, and (3) the Service determines that the need for the source code outweighs the risk of unauthorized disclosure of trade secrets. The provision authorizes courts in summons enforcement proceedings to issue any order necessary to prevent the improper disclosure of trade secrets and confidential information. This provision has a significant impact on audits in the foreign tax credit area.

For communications between taxpayers and any federally authorized tax practitioner concerning tax advice, I.R.C. § 7525 provides a new confidentiality privilege, similar to the traditional common law attorney-client privilege. Federally authorized tax practitioners are persons described in Circular 230 as subject to regulation. "Tax advice" means any advice given with respect to a matter which is within the scope of the individual's authority to practice. The new rule may be asserted to the extent the communication would be considered a privileged communication, if it were between a taxpayer and an attorney, except for written communications made in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter. See I.R.C. §6662(d)(2)(C)(iii).

The Internal Revenue Code under section 6001 requires that taxpayers maintain adequate books and records. Most large taxpayers have document retention agreements with the Service. During the audit, the Service's computer specialist determines whether the records are being maintained and that the agreement is adequate. The Service will accept imaging of documents instead of hard copy. See Rev. Proc. 98-25, 1998-11 I.R.B. 7. If a taxpayer follows the guidelines in 98-25 for imaging and has a complete and accurate electronic imaging of books and records to satisfy section 6001, the hard copies may be destroyed.

Interim Cycle Reviews

The interim cycle reviews create ongoing communications with the Service at a more formal level than the monthly meetings. These meetings should be set up as major reviews throughout the audit. These meetings do not replace the daily communication, or monthly meetings. A taxpayer needs to meet with the case manager, the CEP branch chief, and review the status of the examination, suggest improvements to the examination process and allow the Service an opportunity to present the problems from its perspective. Modification of the examination plan may be necessary.

The taxpayer should review continually the IDR procedures to ensure that they are being followed. The taxpayer needs to evaluate whether issues are being resolved through the IDRs, or is the IDR process only a fishing expedition. The taxpayer needs to review the timeliness of the 5701s for early resolution and the activities of the specialists in the examination.

If possible, the Service always is seeking ways to effectively reduce their time commitment for a particular examination. Thus, the taxpayer needs to provide them an opportunity to reevaluate their examination plan. The Service is trying to optimize the time spent on examinations in the CEP program and hopefully reduce the time for each examination in order to increase the number of audits. Thus, they are willing to listen to ways of concluding audit issues that are susceptible for resolution and promptly sending unagreed issues to Appeals.

The taxpayer should insist on the participation of the CEP branch chief in the interim cycle review. If the audit has reached a very strained relationship between the taxpayer and the audit team, a taxpayer might benefit in having a branch chief that is not personally connected to the audit and can provide a more objective review of the problems and issues and can expedite the orderly progression of the examination during its later stages. If you have a breakdown in the audit, the taxpayer needs to explain to the team coordinator that the audit is at a stalemate and the case manager and the branch chief need to be involved.

As the audit reaches a conclusion, the Exam Group will issue the final 5701s. A taxpayer should avoid the situation of receiving all of the 5701s at the end of the audit. At the opening conference, the taxpayer must establish the flow of the 5701s through the examination cycle and prioritize issues. When an issue has been developed, the taxpayer needs to obtain the 5701, so that he has an adequate time for response. In the 5701, the Service presents the facts it has gathered, its interpretation of the facts, and its application of those facts to the law. The taxpayer should analysis whether he agrees with the facts and usually there is not agreement with the facts as set out by the Service.

If there is disagreement, the taxpayer should outline what he believes are the facts and discuss it with the Service. Hopefully, the taxpayer has been discussing these factual differences before the issuances of the 5701 and will avoid any surprises with the 5701. As the audit progresses, the taxpayer should have three piles of 5701s in agreement, disagreement and pending status.

The potential issues should be discussed prior to the preparation of a 5701. Prior to the 5701 write-up, the facts and the legal interpretations are fluid with the possibility of compromise. The agents have very broad issue resolution authority with respect to looking at the facts and the application of the laws. If the taxpayer resolves an issue with the agent, he should have that resolution apply to all open filed returns by requesting an accelerated issue resolution agreement (or “AIR” agreement) with the district under Rev. Proc. 94-67, 1994-2 C.B. 800.

As long as the taxpayer is in the pre-30-day letter stage, he should work to resolve issues that have been set forth on 5701s, either through negotiations with the agent, or through discussions with the case manager by providing a better understanding of the facts and clarifying the law. If a taxpayer can not resolve it, he may want to move the issues to Appeals under the early referral process.

The industry specialization program (“ISP”) will influence most large case examinations and ISP issues can apply to multiple industries. Since these issues are coordinated on a national basis, the team specialist will be reporting any analysis to the national coordinator. The ISP issues are set out in the Internal Revenue Manual and the Service issues bulletins outlining the issues, including the list of the national contacts that can be called by the taxpayer to discuss the issues.

The ISP paper for examination outlines the future direction of the issue and how the issue is to be developed. At the opening conference, the taxpayer should ask the team coordinator of any possible ISP issues. The Appeals ISP position papers are only released through a Freedom-of-Information-Act (“FOIA”) request. The settlement section in the Appeals paper will not be released, since it is considered protected information. Under Delegation Order 247, the Service delegates hazard-of-litigation settlement authority to the examination case manager in ISP issues. After development of the ISP issue, the revenue agent can discuss settlement on a hazard basis with the taxpayer. However, the agent must get approval from the ISP coordinator before he can settle the issue.

In the course of an audit, field service advice (“FSA”) or technical advice (“TAM”) often will be needed. An FSA is provided by the national office of the Chief Counsel through the District Counsel attorneys to the examining agent. The Service strengthens the technical proficiency of the agents through the support they can receive from Counsel. It is discretionary on the part of the agent whether he will seek an FSA and will follow the FSA received. An FSA does not receive the same intense reviews by the national office as a TAM, but serves the needs of the Service and the taxpayer when it is requested early in the audit and results in the early conclusion of an area of question.

Under I.R.C. § 6110(i), an FSA is subject to disclosure similar to a TAM after the redaction of attorney-client privilege and work-product doctrine materials by the Service and the taxpayer. The taxpayer should request the opportunity to participate in the FSA process, especially since the taxpayer has the right of review and redaction prior to public release. The taxpayer does not have the right to participate in the process, but frequently the agents will grant the taxpayer an opportunity to provide a written analysis of the facts and law for the Counsel attorney. In many cases, the Service has allowed the taxpayer to meet with the Counsel attorney and discuss the issue to ensure that the Counsel attorney and the agent have a complete understanding of the facts involved in the issue. An FSA focuses on providing guidance to the examining agent, while the agent is developing the issue, developing the facts, and applying the law to those facts.

If the issue is fully developed, a TAM may be more appropriate for the taxpayer. Either the Service or the taxpayer can request the formal TAM. The request goes through the I.R.S. District Office to the Chief Counsel’s office. The taxpayer has an active role in the TAM process. He has an opportunity to provide his statement of facts and his statement of law. There has to be an agreement on the facts between the agent and the taxpayer with the application of the law in dispute. The TAM decision is made by the national office of the Chief Counsel. A conference of right is provided whereby the taxpayer can meet with the Chief Counsel’s office and discuss the determination and attempt to obtain a favorable ruling. If it is favorable to the taxpayer, a TAM does commit the Service. If it is unfavorable to the taxpayer, it does not commit Appeals. A TAM is a much more time-consuming process and can delay the audit. If the agent is pursuing an FSA and the taxpayer believes that the agent has already developed all the facts, the taxpayer can definitely influence the FSA procedure by requesting legitimately a TAM and obtaining some participation in the FSA process as an alternative to a longer TAM process.

The agent is not required to inform the taxpayer that he is requesting an FSA, but the taxpayer should request during the opening conference that the agent provide such notification. The Service may not agree to provide the taxpayer an opportunity for any participation, but they should inform the taxpayer when they are submitting for an FSA.

An FSA can be helpful to the taxpayer, since obtaining Counsel advice prior to extensive issue development can save everyone time. However, unless the taxpayer can convince the agent to accept and submit the taxpayer’s facts and legal position, it is the agent’s facts and law upon which the advice is based. If the taxpayer has a very important issue, a TAM should be sought. Although the process takes much longer, the taxpayer’s position on the facts and appropriate laws are presented.

Closing Conference

The closing conference is the taxpayer’s last opportunity to resolve the case with Examination. Although the taxpayer has made his arguments with the agents who disagree, the taxpayer should discuss the unagreed issues again. During the closing conference, the taxpayer has the attention of the upper management from the Examination division. If the taxpayer can resolve issues before they are in the final Revenue Agent Report (RAR), the easier for settlement of the entire audit cycle.

The closing conference is the final opportunity before the examination division. The taxpayer knows their positions, when he goes into the conference. At this point, the taxpayer is trying to close the examination with as few unresolved issues as possible. If he is not successful, he has to make sure that he understands the government's positions. Since many issues can be resolved in the closing conference, a taxpayer should take the opportunity to outline all of the issues. A taxpayer needs to look at the effect of the agreed issues and their effect on the next audit cycle. A taxpayer should obtain a written agreement that they are going to resolve the next cycle on the same basis.

Upon the issuance of the RAR, there may be further discussions of the unresolved issues. If all of the issues are settled in the examination, the case is closed as agreed from examination. If issues remain unagreed, a 30-day letter is issued usually instead of a 90-day letter to permit the taxpayer the opportunity to submit a Protest Letter and to ensure sufficient time for Appeals to review the unagreed issues. The examination team analyzes the Protest usually with Counsel participation. The exam team with Counsel will consider any additional information and will prepare a rebuttal to any Protest Letter. The case is closed to Appeals, if there remains any unagreed issues after the Protest Letter discussions.

Post-Examination Critique

Under the post-examination critique phase, a taxpayer should have two closing sessions. The first one should be with his own internal staff and any outside audit advisors, discussing the weaknesses and the accomplishments of the audit process and the objectives for any future audit. The second post-examination critique is with the Service and is the last part of the examination and the beginning step in planning any future audit.

The taxpayer needs to review whether the examination plan effectively controlled the audit process and what he can do with the Service's next cycle to make the examination less burdensome and less costly. If the taxpayer had a Service member that was very difficult, he needs to explain the problems to the Service. The taxpayer should reduce the interim reviews and post-examination critiques to writing for any future Examination team in another cycle.

The Service has committed resources in trying to resolve issues at the lowest possible level, focusing on early resolution of issues. For example, Delegation Order 236 (Rev. 3) expands the opportunity for a revenue agent to take an agreement that has been negotiated in the Appeals function and apply it in a future year. A taxpayer can use an AIR agreement in all open years that have been filed and enter into a closing agreement with the District Director to resolve that issue for those years.

In summary, a taxpayer must be active in developing a record retention policy and active in deciding when a transaction is coming together what records will be retained and how they will be retained. A taxpayer must be active in developing an examination strategy, active as a participant in developing an examination plan and active throughout the examination process.

ENDNOTES

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MAQUILADORAS MEXICAN INCOME TAX DEVELOPMENTS

By: Alfonso Soto[1]

After months of negotiation the Internal Revenue Service and the Mexican Ministry of Finance have reached a temporary agreement on the tax regime applicable to maquiladoras beginning on January 1, 2000. The agreement avoids what appeared as an imminent and significant blow to the maquiladora industry. The details of the understanding were made public on October 29, 1999, through a news release issued jointly by the tax authorities of Mexico and the U.S. The full text of the IRS news release follows this note.

The agreement gives maquiladoras the opportunity to elect for the application of its multiple benefits. First, the agreement eliminates the risk of creating a permanent establishment in Mexico for U.S. affiliates of maquiladoras, which means that U.S. affiliates will not be subject to income tax in Mexico. Second, the agreement eliminates the tax on assets of the U.S. affiliate that are located and used in Mexico. Third, the maquiladora operation will be considered in compliance with transfer pricing rules under the laws of both countries.

In general, maquiladoras must file the election with the Mexican tax authorities no later than May 31, 2000, to benefit from the terms of the agreement. Maquiladoras that have already applied for transfer pricing rulings in Mexico must file their election by April 30, 2000. At the time of the filing, maquiladoras will have to elect to report income and pay taxes in Mexico under one of the following alternatives:

(1) an increased safe harbor election representing a return of 6.9% on assets used in the maquiladora operation, which will include the assets owned by the maquiladora and those owned by its U.S. affiliates;

(2) a new safe harbor representing a mark-up of 6.5% on costs and expenses incurred by the maquiladora enterprise, which will be determined under Mexican tax law and Mexican GAAP; or

(3) a transfer pricing ruling from the Mexican tax authorities.

The Mexican tax authorities consider these measures as a way of allocating the tax burden between Mexico and the U.S. and not as an increase in taxes for maquiladoras. Technically, these elections will not result in double taxation of income because foreign tax credits will be preserved under U.S. tax principles. A determination to that effect should be made on a case by case basis.

The relief afforded by the agreement applies to the 2000, 2001, and 2002 taxable years. During this three-year period, the tax authorities of Mexico and the U. S. will negotiate permanent rules to address these issues.

On December 28, 1999, the Mexican Ministry of Finance published in the Official Federal Gazette (Diario Oficial de la Federación) additional guidance to comply with the agreement.[2] The resolution of the Ministry of Finance provides information on the following:

(1) rules and adjustments for valuing assets for use in the safe harbor computation;

(2) identification of costs to be included and rules for the safe harbor computation;

(3) the format, content, and place for filing the elections pursuant to the agreement; and

(4) rules for requesting the benefits of the agreement when only a portion of the operations in Mexico are under the maquiladora program.

The development revives the arguments raised for the first time in 1995 when Mexico announced the beginning of enforcement efforts in the transfer pricing arena. Companies with maquiladoras may want to revisit the cost-benefit analysis of a transfer pricing ruling request against safe harbor election. However, this time maquiladoras may be looking at advanced pricing agreements in the cost-plus 6.5% range.

The Agreement appears to reflect the change in view of the Mexican Government towards the maquiladora industry. High level officials within the Ministry of the Treasury (*Secretaría de Hacienda y Crédito Público*) consider that maquiladoras have been subject to very favorable tax treatment and believe that the time to end that is now.

These changes are just one of the many challenges facing the maquiladora industry. Perhaps the most significant is the phase-out of benefits for temporary imports of raw materials and processing equipment. Beginning January 1, 2001, only those goods originating in the U.S. or Canada will be allowed to enter Mexico without duties.

Attorneys advising clients with operations in Mexico should be alert to theses developments since they could have a significant impact in the way to do business in Mexico. The late December approval of the budget and tax reform by the Mexican Congress did not bring significant changes, but the upcoming presidential election in Mexico will likely have a lasting mark on the economy and life of our neighbors to the South.

ENDNOTES

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2. "Décima Primera Resolución de Modificaciones a la Resolución Miscelanea Fiscal para 1999," D.O., 28 de dicembre de 1999.

IRS News ReleasesIRS News Release (IR-INT-1999-13) on Tax Regime Applicable to Maquiladoras

Project Number: IR-INT-1999-13
Document Date: October 29, 1999

TAX REGIME APPLICABLE TO *MAQUILADORAS*

Washington - The Competent Authorities of Mexico and the United States reached a mutual agreement on the tax regime applicable to *maquiladoras*. The agreement provides legal certainty to current and potential investors in the maquila industry by establishing specific procedures to comply with tax provisions applicable in each country, and by eliminating potential double taxation.

The agreement constitutes a Mutual Agreement in accordance with the Convention between Mexico and the United States for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (Tax Treaty).The Competent Authorities agreed that no permanent establishment shall be deemed to exist, provided that *maquiladoras* comply with either of two options.

Terms of the agreement are as follows:

1. Notwithstanding the provisions of Article 5 of the treaty, no permanent establishment shall be deemed to exist provided that the maquila activities carried out by enterprises resident in Mexico comply with either subparagraph 2(a) or 2(b) below.

2. For taxable years 2000, 2001 and 2002:
   a. The taxable income of the maquila enterprise represents at least the higher of

      i) 6.9% of the value of assets owned by a foreign resident and by the maquiladora (the value of the assets owned by the foreign resident shall be computed in accordance with rules 3.33.2 and 3.33.3 of the Mexican Administrative Regulations in force in 1999), used in the maquila activity; or

      ii) 6.5% of the deductions (costs and expenses) of the maquila enterprise. For these purposes, costs and expenses means all ordinary operating expenses, but does not include extraordinary or non-operating items, such as financing costs, exchange gains and losses or casualty losses, as defined by Mexican tax law and Mexican GAAP. The risks associated with such items will remain with the U.S. owner and exchange losses and financing costs will be reimbursable at cost to the maquila enterprise; gains would offset amounts due the maquila enterprise. A similar definition will be provided in Administrative Rule 3.33.1.

b. The enterprise obtains from the Tax Administration Service a ruling (APA) under Article 34-A of the Federal Tax Code (FTC) confirming that it has complied with Article 64-A of the Mexican Income Tax Law (ITL).

The ruling shall take into consideration for the purpose of determining taxable income in Mexico, the concepts and principles already being considered by the Mexican authorities, as well as assets (including inventory) owned by the foreign resident, used in the maquila activity. For these purposes, the value of assets shall, as in 2(a)(i), be computed in accordance with Administrative Rule 3.33.2 ant 3.33.3.

The reference to the consideration of assets is not intended to restrict taxpayers to the use of the return on assets Profit Level Indicator (PLI). Rather, it is intended to provide flexibility to taxpayers to negotiate the appropriate return from the maquila activity, using a methodology or (PLI) that might be more appropriate to its facts and circumstances than the safe harbor described in paragraph 2(a). That is, although assets will be considered', a company would have an opportunity to demonstrate that. on the particular facts of its case, the activities conducted in Mexico would support a return on either costs or assets (as appropriate) and the return may be less than the return called for in the safe harbor. Under appropriate circumstances, a company could demonstrate that certain costs or assets (e.g., idle machinery and equipment or land not being used for manufacturing activities) should in fact generate no return. This would also imply that for purposes of the cost plus, the foreign assets will be taken into consideration in determining an appropriate plus.

The tax authorities will take into consideration any administrative concerns that could arise in valuing foreign owned assets.

3. Maquila enterprises that have applied for or obtained a ruling under Article 34-A of the FTC which covers the year 2000 or subsequent years but which was not issued in accordance with subparagraph (b) must either comply with subparagraph (a) or request a new ruling under subparagraph (b), in order to obtain the benefits set forth under this agreement.
4. The application (full submission) for opting for either paragraph 2(a)(i), 2(a)(ii), or 2(b) must be made no later than May 31st for those taxpayers that have not previously applied for an APA otherwise, the application must be filed no later than April 30".

5. It is understood that maquila enterprises that opt to apply either of the alternatives provided under subparagraphs 2(a) or 2(b) shall be considered to operate under conditions that are made or imposed between independent enterprises, in accordance with the provisions of Articles 64-A and 65 of the ITL, Section 482 of the Internal Revenue Code and Article 9 of the Treaty.

6. If maquila enterprises elect options under subparagraph 2(a) or 2(b) above, the foreign resident will be exempt from the Mexican asset tax on its assets used by those enterprises, in that proportion in which such assets are used for the export of goods included in the maquila program authorized by Mexico's Trade Department That proportion will be measured on the basis of export sales to total sales. See Administrative Rule 4.1.

7. The Competent Authorities shall endeavor beginning in the year 2000 to reach agreement on the permanent rules to be applied to maquila enterprises owned by residents of the United States referred to above. During such discussions, due regard should be given to Mexico's right to tax in accordance with Article 5 of the Treaty.

8. It is our mutual understanding that this agreement in no way constitutes measures for attributing income to a permanent establishment.

It is anticipated that further guidance will be developed to implement the terms of the agreement.

1999 - 2000
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1999-2000 COMMITTEE ROSTER FOR THE SECTION OF TAXATION OF THE STATE BAR OF TEXAS

CONTINUING LEGAL EDUCATION COMMITTEE

This Committee's primary goal is to facilitate quality CLE for members of the Taxation Section. A secondary goal is to provide quality tax related CLE for members of the general bar. The Committee coordinates the scheduling of the various Section-sponsored programs and encourages diversity in program location. The Committee also acts as the planning committee for the State Bar of Texas' Advanced Tax Law Course, now in its 18th year. As a service to the general bar, the Committee works with the State Bar of Texas Professional Development Program to plan tax related courses of interest to non-tax lawyers. In 1995, the Committee's efforts resulted in "Tax Law for the Rest of Us", a general program for non-tax lawyers produced live in Houston and Dallas and by video tour to 37 cities statewide. This year's effort is the tax portion of "entering the Cross Border Market" a program directed at lawyers interested in the U.S.-Mexico market. The Committee's newest project (still in the very early developmental stages) is developing a forum for practitioners to communicate with the Internal Revenue Service. The Committee is hopeful that this activity can be made available to all Taxation Section members and accredited for CLE purposes.

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COMPENSATION AND EMPLOYEE BENEFITS COMMITTEE

This Committee: (i) is a forum for discussion of compensation and employee benefits issues; (ii) sponsors seminars which allow members to both teach and learn compensation and employee benefits practice; (iii) publishes articles in the Texas Tax Lawyer; (iv) prepares comments on legislation and regulations; (v) drafts model forms and makes these available to members; (vi) sponsors legislative initiatives; and (vii) writes amicus briefs in important cases. Members are encouraged to initiate or participate in projects in any of the above areas. Qualified plans, executive compensation, and medical and other welfare benefit plans are subjects for the Committee, which are impacted by such laws as ERISA, federal and state tax laws, labor and discrimination laws, insurance laws, corporate and securities laws, marital property laws, trust laws, and the federal Social Security Act.

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CORPORATE TAX COMMITTEE

The two primary "outputs" of this Committee are (i) organizing the corporate tax portion of the annual Texas Federal Tax Institute (typically held in June), and (ii) providing corporate tax articles for the Texas Tax Lawyer. From time to time, the Committee undertakes to examine legal issues, comment on proposed regulations and update its members on current developments.

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PARTNERSHIP AND REAL ESTATE TAX COMMITTEE

This Committee (which is the result of the merger of the Partnership and Real Estate Tax Committee and the S Corporations Committee) focuses on the Federal income tax issues arising in connection with partnerships and S corporations and in connection with real estate transactions such as sales, exchanges and workouts. In the coming year this Committee will prepare for publication in the Texas Tax Lawyer its annual review of current legislative, regulatory and judicial developments in the partnership, S corporation and real estate tax areas, and it will also take a leading role in the planning and execution of the Annual Texas Federal Tax Institute. Members of this Committee may be involved in either or both of these activities, and they may also be involved in the Committee's newest activity, that being the formation of an ongoing body of practitioners who stand ready to make timely comment to Proposed Regulations and other tax promulgations of the Treasury Department and the Internal Revenue Service.

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PROPERTY TAX COMMITTEE

This Committee serves as a forum for the discussion of ad valorem tax issues. Committee membership is generally comprised of an equal number of attorneys practicing on behalf of property owners and governmental entities. The Committee sponsors an annual seminar in Austin during February of each year. In addition, the Committee co-sponsors the Annual Legal Seminar on Ad Valorem Taxation with the Texas A&M Real Estate Center. Members may participate in the regularly published Committee newsletter, or by serving on the planning or speaker committees for the seminars sponsored by the Committee.

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STATE TAX COMMITTEE

The principal activity of this Committee is meeting annually with officials of the Comptroller of Public Accounts who brief the Committee on pending Texas tax cases, including both administrative hearings and court cases, administrative rule changes, legislative changes and other agency matters. Efforts are being made to reinstitute the practice of the Comptroller delivering to the Committee in draft form proposed administrative rules and the Committee compiling and delivering to the Comptroller comments to such drafts.

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TAX CONTROVERSY COMMITTEE

This Committee focuses on all aspects of tax controversy and tax litigation, including civil and criminal, federal and state. The Committee sponsors a seminar each year on current procedural topics with speakers from the private bar, the Internal Revenue Service, State taxing authorizes and the Judiciary. The Committee is also responsible for submitting articles to the Texas Tax Lawyer. In this regard, the Committee plans to publish an annual procedural update and a report on the annual Mid states Region IRS/Bar Liaison meeting.

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TAX-EXEMPT ORGANIZATIONS COMMITTEE

This Committee focuses on issues related to tax exempt organizations. The Committee is responsible for submitting articles to the Texas Tax Lawyer. The Committee will also be embarking on a joint project with the Business Law Section's Nonprofit Corporation Committee to create a guidebook for forming a nonprofit corporation that also will include information on applying for tax exemption.

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