SHEARMAN & STERLING LLP

Practice Group Newsletter

FOCUS ON TAX CONTROVERSY AND LITIGATION

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Editor's Note

Dear Readers,

This issue features articles discussing the Third Circuit's recent decision in the long-awaited tax credit case *Historic Boardwalk Hall LLC v. Commissioner*, the Eleventh Circuit's holding in *Shockley v. Commissioner* that the filing of a petition challenging an invalid notice of deficiency suspends the assessment period, and the Seventh Circuit's opinion in *In Re: Special February 2011-1 Grand Jury Subpoena Dated September 12, 2011* compelling production of bank records required to be maintained under the Bank Secrecy Act over the taxpayer's assertion of the Fifth Amendment privilege.

If you have comments or suggestions for future publications, you may contact Lawrence M. Hill at lawrence.hill@shearman.com. They are very much appreciated.

IN THIS ISSUE

Third Circuit Reverses Tax Court in *Historic Boardwalk*

The U.S. Court of Appeals for the Third Circuit released its opinion in *Historic Boardwalk Hall LLC v. Commissioner*,[1] reversing the Tax Court's decision in favor of a partnership that had earned historic rehabilitation tax credits ("HRTCs") under section 47.[2] Section 47 provides that a taxpayer owning a property interest is eligible for a tax credit equal to 20 percent of the qualified rehabilitation expenditures with respect to any certified historic structure.

Background

According to the Third Circuit's lengthy discussion of facts, the New Jersey Sports and Exposition Authority ("NJSEA") owned East Hall, a building on the National Register of Historic Places as a National Historic Landmark. In 1998 the NJSEA began extensive and expensive renovations to East Hall. The same year, a consulting firm suggested to the NJSEA that it seek a corporate partner that could take advantage of the HRTCs. The NJSEA decided sell the HRTCs and had an offering memorandum circulated among potential investors including, Pitney Bowes ("PB"). Ultimately the NJSEA and PB agreed that PB would make capital contributions in exchange for a 99.9 percent membership interest in Historic Boardwalk Hall, LLC ("HBH"), a partnership that the NJSEA had recently formed. Under the terms of the agreement, PB would receive a 3 percent preferred return and 99.9 percent of approximately $17.6 million in HRTCs.

Court's Discussion

The taxpayers tried to persuade the court that the evidence proved that PB was a bona fide partner: HBH was formed for a valid business purpose, PB made a significant investment in HBH, and the partners generally acted like partners in a business venture. But the Third Circuit rejected the taxpayer's arguments in favor of the government's contention that PB should not be treated as a bona fide partner in HBH because PB lacked a meaningful stake in the success or failure of the partnership and had no meaningful downside risk or meaningful upside potential in HBH. The government pointed the appellate court to two cases, *TIFD III-E, Inc. v. United States* ("*Castle Harbour*")[3] and *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner* ("Virginia Historic"),[4] which the government stated "'provide a highly pertinent frame of reference for analyzing the instant case.'" In *Castle Harbour*, the U.S. Court of Appeals for the Second Circuit agreed with the government that purported bank partners were not bona fide partners because they had no meaningful stake in the partnership. In *Virginia Historic*, the U.S. Court of Appeals for the Fourth Circuit sidestepped the issue of whether the taxpayers were bona fide partners in a partnership that shared state tax credits for historic rehabilitation projects. Instead, the Fourth Circuit analyzed the transactions under the disguised sale theory of section 707(b) and concluded that the purported partners were more akin to purchasers than business co-venturers.

The Third Circuit analyzed the partnership under the *Culbertson*'s totality-of-the-circumstances test,[5] considering all the facts, including the partnership agreement, the parties' conduct in the execution of its provisions, the parties' statements and their relationship, the parties' respective abilities and capital contributions, the testimony of disinterested parties, and the actual control of income. According to the Third Circuit, PB was all but certain to get back the contributions that it made to HBH and receive the HRTCs. Also, the Third Circuit stated that any risk that PB would not receive all its bargained-for HRTCs if the rehabilitation project was unsuccessful was eliminated because the project was

[1] No. 11-1832 (3d Cir. filed Aug. 27, 2012).

[2] All section references are to the Internal Revenue Code and all references to regulations are to the Treasury regulations issued thereunder, unless otherwise noted.

[3] 459 F.3d 220, 232 (2d Cir. 2006).

[4] 639 F.3d 129 (4th Cir. 2011).

[5] 337 U.S. 733 (1949).

already fully funded before PB agreed to contribute to the project. PB, the Third Circuit concluded, never acquired a bona fide partnership interest in HBH.

– E. McGee

Eleventh Circuit Court Reverses Tax Court in *Shockley*, Rules Tax Court Petition Tolls Assessment Period

On July 11, the U.S Court of Appeals for the Eleventh Circuit reversed the Tax Court in *Shockley v. Commissioner* and held that a Tax Court petition, which challenged a notice of deficiency as invalid, was a proceeding in respect of the deficiency to suspend the period of limitations on assessment under section 6503(a)(1). The key issue before the circuit court was whether a petition filed in Tax Court to challenge an alleged invalid notice of deficiency suspended the assessment period.[6]

Generally, the Internal Revenue Service ("IRS") must assess the liability of a taxpayer within three years after the taxpayer's return was filed.[7] To assess a claim against a transferee, the IRS must assess the taxpayer's tax deficiency against a transferee within one year of the expiration of the three-year limitations period for assessment. Any suspension or tolling of the three-year limitation period applicable to the taxpayer-transferor extends the limitation period applicable to the transferee (here, the Shockleys). Pursuant to section 6503(a)(1), the three-year limitation period "shall (after the mailing of a notice under section 6212(a)) be suspended for the period during which the Secretary is prohibited from making the assessment . . . (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter."[8]

In *Shockley*, the IRS, following a corporate tax audit, issued on February 18, 2005, two nearly identical notices of deficiency regarding Shockley Communications Corporation ("SCC"). The IRS mailed one notice of deficiency to "Shockley Communications Corporation" at the Washington, D.C. address reported on SCC's 2001 tax return. The notice identified the taxpayer as SCC and listed SCC's taxpayer identification number. On the same date, the IRS mailed a second, nearly identical notice of deficiency to SCC, with a Madison, Wisconsin address on the notice, which was the then-home address of Terry and Sandra Shockley. The Shockleys were former shareholders and also served as officers and directors of SCC prior to the sale of SCC in May 2001 to Northern Communications Acquisition Corporation, an unrelated third party. The Madison notice mailed to the Shockleys listed only SCC's taxpayer identification number on the notice. Both notices contained similar language that the taxpayer owed additional tax and that "[i]f you want to contest this determination . . . you have 90 days from the date of this letter . . . to file a petition with the United States Tax Court for a redetermination of the deficiency."[9]

In response to the second notice mailed to the Madison, Wisconsin address, the Shockleys timely filed a petition in Tax Court on May 25, 2005. The petitioners included the Shockleys as well as SCC. The petition stated that it was filed on behalf of petitioners and alleged that the notice was invalid because (i) the notice improperly named the Shockleys individually and not as transferees, and (ii) the notice was improperly addressed and delivered to the personal Shockley residence, not to the business address of SCC.

On April 26, 2007, the Tax Court granted the Shockleys' unopposed motion to dismiss the 2005 petition for lack of jurisdiction because the Shockleys lacked capacity to act

[6] *Shockley v. Commissioner*, Nos. 11-13494, 11-13495 and 11-13497 (11th Cir. July 11, 2012).

[7] § 6501(a).

[8] § 6503(a)(1).

[9] *Shockley v. Commissioner*, Nos. 11-13494, 11-13495 and 11-13497 (11th Cir. July 11, 2012), slip op. at 5.

on SCC's behalf. Following the dismissal, in September 2007, the IRS assessed tax, penalty, and interest of SCC. The IRS thereafter undertook an examination and concluded that the Shockleys were "transferees" of SCC's assets and liable as transferees for SCC's tax deficiency. In August 2008, the IRS mailed the Shockleys a notice of transferee liability for SCC's deficiency, and on November 19, 2008, the Shockleys timely filed a petition in Tax Court for redetermination of their respective transferee liability. According to the Shockleys, the IRS could not assess their liability as transferees because, in part, the IRS did not timely assess the original corporate tax deficiency against SCC until September 2007, and the three-year statute of limitations for assessment of the transferor's alleged tax deficiency expired allegedly in July 2005. The IRS posited that the notices of transferee liability were timely because the Shockleys' 2005 Tax Court petition constituted a "proceeding in respect of [SCC's] deficiency that suspended the limitations period under section 6503(a)(1)."

The Eleventh Circuit Court agreed with the IRS and concluded that the 2005 Tax Court petition was a "proceeding" that sufficiently concerned SCC's deficiency such that it was "in respect of" the SCC deficiency, within the meaning of section 6503(a)(1). The appellate court's decision rested on two principle reasons. First, the court held that a proceeding need only be "in respect of" the deficiency, not seeking "a redetermination of" the deficiency, finding that the phrase "in respect of" is "particularly comprehensive."[10] Contrasting the language in section 6213(a), a closely related statute, the court noted that Congress "selected the more specific phrase 'redetermination of' the deficiency." The court concluded that the phrase in section 6503(a)(1) "in respect of" requires "only that the substance of the proceeding concern the deficiency."[11]

Second, the Eleventh Circuit found that section 6503(a)(1) referred only to a "proceeding", whereas section 6213(a) referred to the "'taxpayer' filed a 'petition' for 'redetermination of' the deficiency." [12]

The Shockleys argued that the 2005 tax court petition did not suspend the statute of limitations under section 6503(a)(1) because it was filed in response to the invalid Madison notice regarding SCC's deficiency, rather than the valid D.C. notice about the same SCC deficiency. The court rejected the Shockleys' argument that the statute required that the Tax Court petition be filed in response to a valid notice. While sensible, the Eleventh Circuit concluded that was not the statute that Congress had written.

Lastly, the Court followed *Badaracco v. Commissioner*,[13] requiring strict construction of section 6503(a)(1) because the case involved the interpretation of a plain and unambiguous statute of limitations sought to bar the rights of the government. Recognizing that it must strictly construe section 6503(a)(1) in favor of the government, the Eleventh Circuit declined to interpret the statute such that the IRS would be faced with a Hobson's choice of either "(1) treating a proceeding posing a jurisdictional problem as a 'nullity,' proceed to assessment, and hope not to run afoul of the statutory prohibition against assessment; or (2) do nothing until the Tax Court ruled and hope the Tax Court did so before the statute of limitations expired." [14]

– *R. Nessler*

Seventh Circuit Compels Taxpayer to Produce Bank Records Under Required Records Doctrine

On August 27, the U.S. Court of Appeals for the Seventh Circuit held in favor of the government, compelling

[10] *Id.*, slip op. at 16 – 17.

[11] *Id.* at 17.

[12] *Id.*

[13] 464 U.S. 386 (1984).

[14] *Shockley v. Commissioner*, Nos. 11-13494, 11-13495 and 11-13497 (11th Cir. July 11, 2012), slip op. at 23.

production of bank records required to be maintained under 31 C.F.R. section 103.32 of the Bank Secrecy Act[15] in *In Re: Special February 2011-1 Grand Jury Subpoena Dated September 12, 2011*.[16] Earlier, a district court had found that the act of producing the requested records was incriminating and that the Required Records Doctrine was inapplicable. The Seventh Circuit's opinion, which references last year's decision in a similar case by the U.S. Court of Appeals for the Ninth Circuit in *In Re Grand Jury Investigation M.H.*,[17] is consistent with the Ninth Circuit's holding that the Required Records Doctrine does indeed apply to information required to be kept and maintained for government inspection and reported annually through Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR").

Following a grand jury subpoena of the bank records he was required to maintain under 31 C.F.R. section 103.32, the appellee, identified only as "T.W." for "target witness," filed a motion to quash the subpoena on the grounds that producing the records would violate his Fifth Amendment privilege against self-incrimination. Complying with the subpoena could reveal that he had failed to report bank accounts that should have been reported; alternatively, denying having the requested records could similarly expose T.W. to criminal liability because the Bank Secrecy Act defines failure to keep the records as a felony.

Required Records Doctrine and the Act of Production Privilege

If the criteria of the Required Records Doctrine are satisfied, the Fifth Amendment privilege against compelled, testimonial self-incrimination is no defense to a subpoena compelling production of such records. Under the Required Records Doctrine, "'the privilege which exists as to private papers cannot be maintained in relation to records required by law to be kept in order that there may be suitable information of transactions which are the appropriate subjects of governmental regulation,'"[18] Three requirements must be met for the Required Records Doctrine to apply: (1) the purposes of the government inquiry must be essentially regulatory; (2) the information to be obtained by requiring the preservation of records is of a kind that the regulated party has customarily kept; and (3) the records themselves have assumed public aspects that render them at least analogous to a public document.

The act of production privilege acknowledges that, while the contents of a document may not be privileged, its production under government compulsion may still be privileged under the Fifth Amendment if the document's contents are incriminating.

Court's Analysis of Parties' Arguments

The Seventh Circuit quickly disposed of all T.W.'s arguments, concluding that many were mischaracterizations of the Required Records Doctrine. Under the Seventh Circuit's analysis (like the Ninth Circuit's in *In Re Grand Jury Investigation M.H.*), the Required Records Doctrine is an exception to the Fifth Amendment privilege against self-incrimination, rather than a threshold test to determine whether there is such a privilege – the position that T.W. had advanced on appeal. Further, the Seventh Circuit stated that the policy reasons underlying the Required Records Doctrine – "that the government or a regulatory agency should have the means, over an assertion of the Fifth Amendment Privilege, to inspect the records it requires an individual to keep as a condition of voluntarily participating in that regulated activity" – would be frustrated if the Required Records Doctrine did not apply in instances in which the act of production privilege was invoked. Accordingly, the Seventh Circuit reversed the district court's order granting T.W.'s motion to quash the grand jury subpoena.

– E. McGee

[15] 31 C.F.R. § 103.32 was renumbered 31 C.F.R. § 1010.420 effective March 1, 2011.

[16] No. 11-3799 (7th Cir. filed Aug. 27, 2012).

[17] 648 F.3d 1067 (9th Cir. 2011).

[18] *Id.* (citing *Shapiro v. US*, 335 U.S. 1, 33 (1948)).

Second Circuit Affirms Tax Court in *Exxon* Global Interest Netting Case

The U.S. Court of Appeals for the Second Circuit has affirmed the decision of the Tax Court,[19] which held that Exxon Mobil was entitled to retrospective "netting" of interest for periods of overlapping underpayments and overpayments, even where the statute of limitations for one leg of the overlapping periods had expired. In so holding, the Second Circuit disagreed with the conclusions of the U.S. Court of Appeals for the Federal Circuit in an earlier case involving the same issue.[20]

Background

Following an IRS examination of Exxon's federal tax returns for tax years 1975 through 1980, the IRS determined that Exxon had underpaid its income tax liabilities for tax years 1975 through 1978 and overpaid its income tax liabilities for tax years 1979 and 1980. It was not disputed that, as a result, Exxon owed no net tax, but as it had already paid interest on the underpayments, Exxon requested administrative interest netting relief from the IRS under section 6621(d). At the time that Exxon made its request, in December 1999, the period of limitations for a claim for adjustment of interest on a tax overpayment or underpayment may have expired for the underpayment leg of the overlapping period but was still open for the overpayment leg.

The dispute arose over the meaning of section 6621(d) and a related statutory, but uncodified, "special rule." Section 6621(d) provides for global interest netting in the case of overlapping periods of tax overpayments and underpayments. The statutory special rule makes section 6621(d) applicable to periods before the effective date of the statute, July 22, 1998, subject to certain conditions, including, "[s]ubject to any applicable statute of limitation not having expired with regard to either a tax underpayment or a tax overpayment."[21] The question presented in the Tax Court and on appeal to the Second Circuit was whether the special rule allowed for retrospective global interest netting when the limitations period for only one of the legs of the period of overlapping indebtedness was still open, or only when the period of limitations for both legs was open.

Tax Court Decision

The Tax Court sided with Exxon, holding that the special rule applied when at least one leg of the period of overlapping indebtedness remained open. The Tax Court rejected the argument of the IRS that this special rule constituted a waiver of sovereign immunity that must be strictly construed in favor of the government. The Tax Court instead construed the provision broadly, in view of the fact that the provision was remedial and designed to provide the maximum feasible relief to taxpayers owing no net tax. The IRS also asked the Tax Court to give *Skidmore* deference to a revenue procedure stating that the special rule required both periods of limitation applicable to the tax underpayment and the tax overpayment to be open on the effective date of the statute.[22] The Tax Court determined, however, that *Skidmore* deference was not appropriate for this revenue procedure, as the revenue procedure was merely prescriptive and did not provide legal reasoning for its stated requirements.

Second Circuit Appeal

The IRS appealed the Tax Court's decision, arguing primarily that the Tax Court erred in failing to recognize that the special rule was a waiver of sovereign immunity. The IRS argued that the special rule was such a waiver because it "authorizes recovery of certain retroactive refund claims for overpaid interest and thus 'discriminates between those claims for overpaid interest Congress has authorized and those it has not.'" The

[19] *Exxon Mobil Corp. v. Commissioner*, Doc. No. 11-2814 (2d Cir. Aug. 8, 2012); *Exxon Mobil Corp. v. Commissioner*, 136 T.C. 99 (2011).

[20] *Fed. Nat'l Mortg. Ass'n v. US* ("*Fannie Mae*"), 379 F.3d 1303 (Fed. Cir. 2004).

[21] IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3301(c)(2), 112 Stat. 2681 (1998).

[22] Rev. Proc. 99-43, 1999-2 C.B. 579.

Second Circuit determined that the special rule did not create jurisdiction or authorize claims against the United States, and thus was not a waiver of sovereign immunity. In so holding, the Second Circuit disagreed with the conclusion of the Federal Circuit in *Fannie Mae* that the special rule was a waiver of sovereign immunity and was to be strictly construed in favor of the government.

The Second Circuit registered its agreement with the Federal Circuit in *Fannie Mae* on two arguments raised by the IRS in that case but which the IRS had since dropped: that Revenue Procedure 99-43 was not entitled to either *Skidmore* or *Chevron* deference; and that a Joint Committee on Taxation "Blue Book" describing the special rule is not legislative history and therefore not entitled to much weight in a court's consideration.

The Second Circuit held further that the language of the special rule was ambiguous but that "the structure of section 6621(d) as a whole, as well as its historical context and [remedial] purpose," makes clear that taxpayers may benefit from retrospective global interest netting even when the limitations period for one of the legs of the overlap has expired.

– *J. Fisher*

District Court Holds Work-Product Protection Does Not Apply to Tax Reserve Work Papers

The U.S. District Court for the District of Massachusetts granted the government's motion to compel production of tax reserve work papers and advice relating to the IRS audit of a STARS transaction but denied the government's motion to compel production of post-closing advice regarding changes in law and the unwinding of the transaction in *Santander Holdings USA v. US*.[23]

The August 6 opinion and order in *Santander Holdings* compels production of the taxpayers' tax reserve work papers. Although the issue of whether work-product protection applies to tax reserve work papers remains hotly contested, this decision comes as no surprise – the U.S. Court of Appeals for the First Circuit, which decided *United States v. Textron*,[24] has appellate jurisdiction over the Massachusetts District Court. In *Textron*, the First Circuit ruled 3-2 (*en banc*) that Textron's tax accrual workpapers were not protected by the work-product privilege after earlier ruling 2-1 that tax accrual workpapers were protected.[25]

The Massachusetts District Court did not compel production of documents relating to advice regarding law changes and unwinding the transaction because the parties agreed that reliance on an advice-of-counsel defense waived all privileged communications concerning the subject matter of the waiver. The taxpayer's defense relied upon advice regarding whether to enter into the STARS transaction; accordingly, by relying on the advice of counsel defense with respect to entering into the transaction, the taxpayer did not waive protection for communications regarding later changes in law and unwinding the transaction.

Finally, the district court compelled disclosure of advice relating to the IRS audit of the STARS transaction after the taxpayer intentionally disclosed a memorandum from an outside accounting firm. The court stated that although the memorandum fell within the scope of privileged communications, the taxpayer's voluntary disclosure constituted a waiver of the privilege.

– *E. McGee*

IRS Publishes Draft FATCA Forms for Foreign Intermediaries and Passthrough Entities

On August 14, the IRS published a new draft Form W-8IMY that allows foreign intermediaries and

[23] 1:09-cv-11043-GAO (D. Mass. filed Aug. 6, 2012).

[24] 577 F.3d 21, 23 (1st Cir. 2009) cert. denied, 130 S. Ct. 3320 (2010).

[25] *But see United States v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010) (work-product material protected if prepared in anticipation of litigation and serves more than one purpose).

passthrough entities to inform withholding agents as to the extent to which payments to such foreign intermediaries and passthrough entities are subject to FATCA withholding tax.

As expected by many, the new Form is longer and more complicated than the previous Form W-8IMY and many experts believe that, at least in the beginning, there will be a high error rate in the submission of the new Form.[26]

A complete analysis of the new Form and how burdensome it will be to complete is impeded by the fact that final FATCA regulations have yet to be released. Additionally, the IRS has not yet released instructions to accompany the Form.

In June, also as a consequence of FATCA, the IRS released draft Form W-8BEN "Certificate of Foreign Status of Beneficial Owner for United States Withholding (Individual)" and draft Form W-8BEN-E "Certificate of Foreign Status of Beneficial Owner for United States Withholding (Entities)".

– D. Jones

IRS Will No Longer Use Tiered Issues Process

On August 17, the IRS issued a Large Business and International Division (LB&I) Directive (the "Directive") announcing that it will no longer use the "Tiered Issues Process" to provide guidance to examiners and address certain corporate tax issues.[27] The Tiered Issues Process was initially developed by LB&I in an effort to combat tax shelters in a consistent manner. After further review of the Tiered Issues Process, LB&I concluded that, although tiering was helpful with respect to tax shelter issues, a new approach was needed to provide guidance to examiners. Specifically, the new approach is meant to provide clear and timely guidance, promote collaboration, increase accountability and transparency, and enable robust communication with taxpayers.

The new approach will implement knowledge management networks to replace the Tiered Issues Process, using Issue Practice Groups ("IPGs") to address domestic issues and International Practice Networks ("IPNs") to address international issues. The Directive explains that the new approach should provide a more consistent and efficient way for examination teams to manage their cases and obtain technical advice.

According to the Directive, examiners, managers and executives can rely on the IPGs and IPNs as a resource during the audit process, and agents are encouraged to use the IPGs and IPNs to obtain guidance when they encounter new or complex issues. The new approach set forth in the Directive indicates an increased emphasis on cooperation and collaboration among LB&I employees during the examination process.

The Directive states that Tier I, II, and III issues will not be listed as of August 17, but instead will be addressed in the same manner as any other issue in an audit. Industry Director Directives ("IDDs") and other IRS Administrative Guidance on the Tiered Issues Process will no longer be valid. Relevant guidance in the IDDs regarding the risk of an issue may be provided by the IPGs and IPNs through their websites, and IRS Administrative Guidance will be updated to reflect the end of the use of tiering after a thorough review.

– M. Lang

IRS Making Use of Whistleblowers to Investigate International Tax Crimes

Tax Notes reported that the IRS is extensively utilizing information provided by whistleblowers to further its

[26] *See* Jamie Arora, "IRS Releases FATCA Draft Forms for Foreign Intermediaries and Passthrough Entities," *Tax Notes Today*, August 15, 2012.

[27] *See* Heather C. Maloy, "Tiered Issues," LB&I Industry Director Guidance, LB&I-4-0812-010 (Aug. 17, 2012), *available at* http://www.irs.gov/businesses/corporations/article/0,,id=259279,00.html.

investigations of international tax crimes.[28] Section 7623(b) provides for financial awards to whistleblowers who contribute to successful tax enforcement actions. The size of the award is based on the extent of the recovery and the significance of the whistleblower's assistance. Previous reports suggested that fewer informants were providing information under the program.[29] In fiscal year 2011, the IRS received 314 reports under section 7623(b), down from 422 reports in 2010 and 472 reports in 2009. Some critics argue that the IRS has mishandled the program and has discouraged potential whistleblowers from coming forward. During a recent ABA Section of Taxation webcast, however, IRS attorney John McDougal emphasized the importance of the whistleblower program and the agency's hope that the program will continue to grow.[30]

McDougal called the whistleblower program "an incredibly valuable opportunity" for the IRS, in part because it provides the government with information from sources outside the U.S. that are unavailable through traditional investigation methods.[31] During the webcast, McDougal stated that the IRS is making frequent use of such information. He suggested that the data given to the IRS by informants is the second most important source of information for international tax enforcement, after the offshore voluntary disclosure initiative, which has had more than 33,000 participants. The IRS has already begun distributing whistleblower awards under the program, with at least three payments completed. The fieldwork on over 60 other cases is finished as well, with more payments likely in the future. McDougal stated that the award payments for the whistleblower program have not been made quickly because they are the final step in a long process. Payment can only be made after the government collects taxes and the taxpayer can no longer request a refund, whether by the expiration of the statute of limitations or an agreement with the taxpayer to waive the right to file a claim for a refund.[32]

To improve administration of the whistleblower program, the IRS has issued interim guidance that clarifies the procedure for making award determinations after the appropriate documents are received by the Whistleblower Office.[33] This includes the Form 11369, or the "Confidential Evaluation Report on Claim for Award," which evaluates and documents the whistleblower's contribution for the purposes of determining a financial award. When taxes are collected that cannot be refunded, a preliminary award determination is made by the Whistleblower Office and sent to the whistleblower along with various other documents for his or her review. Payment is then made after the whistleblower has exhausted or waived any right to appeal the award determination.

The recent guidance and IRS emphasis on the importance of the program, along with the publicity from the payment of awards, may lead to more informants taking part in the whistleblower program in the future.[34] During the ABA webcast, McDougal stated that the IRS is "very hopeful that the whistleblower process will continue to give it valuable, actionable information about offshore activity."

– D. Smith

Tax Court Adopts Rule Changes

The U.S. Tax Court has adopted amendments to its rules of practice and procedure.[35] The court had originally

[28] Jaime Arora, "Whistleblowers Are Key to IRS's International Enforcement Efforts," *Tax Notes*, Aug. 20, 2012.

[29] Jeremiah Coder, "IRS Whistleblower Office Report Cites Lower Submissions, Awards," *Tax Notes*, June 25, 2012.

[30] Arora, *supra* note 28.

[31] *Id*.

[32] *Id*.; Joseph DiSciullo, "Whistleblower Office Amends Award Determination Procedures," *Tax Notes*, Aug. 20, 2012.

[33] *Id*.

[34] Arora, *supra* note 28.

[35] *See* Press Release, U.S. Tax Court, July 6, 2012, *available at* http://www.ustaxcourt.gov/press/070612.pdf.

proposed changes in a press release dated December 28, 2011,[36] and the adopted changes make certain revisions to the proposed amendments. In addition to conforming changes, the court has made changes to the rules regarding filing, discovery, summary judgment, commencement of partnership actions, and the addition of new privacy protections for whistle blower actions.

Many of the changes are in response to the court's successful implementation of electronic filing ("e-filing"). Most notable among these are the changes to Rules 23 and 26 that reduce the number of copies of papers to be filed to the court to just the original and one conformed copy. This reduction applies to all tax cases; as such, Rule 175 (applicable to small tax cases) was eliminated. The court also amended Rule 23(d), permitting use of proportional fonts (*e.g.*, Times New Roman) in papers filed with the court. The changes to Rule 26 formalize the e-filing requirements by mandating e-filing in most cases, except for *pro se* litigants (including those represented by clinics and *pro bono* programs) and any counsel who can show good cause for exemption.

The court also adopted amendments to track recent changes to the Federal Rules of Civil Procedure ("FRCP"). First, the court amended Rules 70 and 143 to provide that draft expert witness reports and pretrial communications between counsel and experts are not discoverable. New paragraph (c)(3) in Rule 70 formalizes the court's application of the work product doctrine. Second, Rule 121 (regarding summary judgment) was also amended to substitute the phrase "genuine dispute" for "genuine issue." The court explained that while this change better reflects the focus of the summary judgment determination, this amendment was not intended to change the substantive operation of Rule 121. Third, Rule 121 was amended to permit the use of an unsworn written declaration in support of summary judgment.[37]

In addition, the court adopted a change to Rule 241, Commencement of Partnership Actions, increasing the time period for notice to be furnished by a tax matters partner to the partners from 5 to 30 days. This change conforms the court's requirements to the notice provisions of Treasury regulation section 301.6223(g)-1(b).

Finally, the court adopted new Rule 345, providing privacy protections for filings in whistleblower actions. The new rule provides that petitioners in a whistleblower action may move the court for permission to proceed anonymously, and also provides that all parties filing papers with the court in a whistleblower action shall redact identifying information. The new rule responds to concerns raised by Deborah Butler, Associate Chief Counsel of the IRS, and Nina Olson, National Taxpayer Advocate, regarding the need for appropriate privacy protections in whistleblower actions.

– G. Feige

[36] *See* Press Release, U.S. Tax Court, "Notice of Proposed Amendments to Rules," Dec. 28, 2011, *available at* http://www.ustaxcourt.gov/press/122811.pdf.

[37] The court also introduced new Form 18, "Unsworn Declaration Under Penalty of Perjury," in accordance with the adoption of this amendment.

Shearman & Sterling's Tax Controversy Practice

Shearman & Sterling's Tax Controversy and Litigation practice is centered on large-case tax controversy examinations, tax litigation matters and government investigations. Our prominent team of nationally recognized trial lawyers represents taxpayers at the audit and appeals stages before the Internal Revenue Service and litigates on behalf of taxpayers in the federal courts, from the U.S. Tax Court to the Supreme Court of the United States. Shearman & Sterling's tax lawyers also represent clients in obtaining rulings from tax authorities and in competent authority proceedings and work with clients to obtain advance pricing agreements.

In addition, our tax lawyers are active members of the American Bar Association Section of Taxation ("ABA Tax Section"), the New York State Bar Association Tax Section ("NYSBA Tax Section"), the Wall Street Tax Institute, and the Institute of International Bankers. One partner recently served as chair of the NYSBA Tax Section; another recently ended his term as Chair of the ABA Tax Section's Court Practice and Procedure Committee. Our tax controversy lawyers frequently participate in panels at tax law conferences and publish articles regarding significant tax controversy and litigation developments.

If you wish to receive more information about or discuss Shearman & Sterling's tax controversy practice, you may contact Lawrence M. Hill at lawrence.hill@shearman.com or (212) 848-4002 or your Shearman & Sterling relationship partner.

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This newsletter is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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