

# Standard Federal Tax Reports *Taxes On Parade*

Vol. 96, Issue No. 36, Report 35

August 20, 2009

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## En Banc First Circuit Rules For IRS In Textron Accrual Disclosures

◆ *Textron, CA-1, August 13, 2009*

In an *en banc* decision, the U.S. Court of Appeals for the First Circuit has overturned a panel decision, which had protected tax accrual workpapers under the work product doctrine. A strong dissent chastised the majority for rejecting precedent.

■ **CCH Take Away.** “The opinion did not come as a surprise to me in terms of its holding that the tax accrual work papers are not work product, in the traditional sense, because they are not prepared because of the prospect of litigation, but for financial statement purposes. However, the breadth and ramifications of the opinion is a surprise,” Lawrence Hill, partner, Dewey & LeBoeuf, New York, told CCH. “The court went further than it had to and departed from the “because of test” in that it required that work product be prepared for use in litigation rather than because of the prospect of litigation,” Hill said.

■ **Comment.** “One hopes that decision will not embolden the IRS to abandon its modified policy of restraint (Announcement 2002-63), whereby it limits requests for tax accrual workpapers to taxpayers engaging in listed transactions,” Robin Greenhouse, partner, McDermott, Will, & Emery LLP, Washington, D.C., told CCH.

(SILO) transactions. The IRS issued an administrative summons to the taxpayer requesting disclosure of the taxpayer’s tax accrual workpapers.

The taxpayer challenged the IRS’s petition to enforce the summons in federal district court, claiming that the workpapers were protected by the attorney-client, tax practitioner, or work product doctrine privileges. The IRS countered that the taxpayer had waived any applicable privilege by disclosing the workpapers to an independent auditor.

### District and panel decisions

Although it found that the company had waived the attorney-client and tax practitioner privileges by disclosing the workpapers to the auditor, the district court found that the documents were protected by the work product privilege. The court held that the documents were prepared “because of” the prospect of litigation.

A panel of the First Circuit in January of this year upheld the district court, holding that tax accrual workpapers were protected under the work product doctrine as “dual-purpose” documents, both prepared in anticipation of litigation and for a business reason.

### En banc decision

Amid controversy surrounding its panel decision, however, the First Circuit subsequently agreed in March to rehear the case *en banc*. The work product privilege, the court noted, aims at protecting work done for litigation and not in preparing financial statements. The taxpayer’s

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### Background

One of the taxpayer’s subsidiaries purportedly participated in nine sale-in, lease-out

Route to:

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## IRS, UBS Reach Tax Probe Settlement; Terms Not Yet Disclosed

The IRS and Swiss banking giant UBS AG have settled their dispute over alleged offshore tax evasion. The U.S. and Swiss governments are expected to announce the details of the out-of-court agreement shortly.

■ **CCH Take Away.** “The question remains if the Swiss government will allow customers to block the release of the information,” James Mastracchio, partner, Caplin Drysdale Chartered, Washington, D.C., told CCH. “This would be a very long process unless the agreement would include an expedited procedure.”

### Summons

The agreement came shortly before an August 17 hearing on the IRS’s request that the U.S. District Court for the Southern District of Florida enforce a John Doe summons against UBS. The IRS alleged that as many as 52,000 U.S.

taxpayers had violated U.S. tax law by failing to properly disclose their UBS accounts.

UBS, backed by the Swiss government, refused to disclose the identities of account holders. The Swiss government warned that it would block any wholesale transfer of client names to the IRS.

### Settlement

After high-level meetings, Secretary of State Hillary Clinton announced on July 31 that the countries had reached a settlement. An attorney with the U.S. Department of Justice (DOJ) confirmed the settlement in a conference call on August 12.

“We are pleased to have initialed an agreement with the Swiss government that protects the U.S. government’s interest,” IRS Commissioner Douglas Shulman said in a statement. “We will release more details when the Swiss government signs the agreement.”

### Account holders

Neither the IRS nor UBS have yet indicated how many, if any, account holders will be identified under the agreement. The IRS declined to respond to media reports for CCH that the number will be in the neighborhood of 10 percent of the alleged 52,000 account holders.

■ **Comment.** “Even if the IRS would secure 10 percent of the names, the agency does not have the resources to open 5,000 criminal investigations yet alone 5,000 civil audits,” Mastracchio noted. Mastracchio predicted that the IRS may not release the names until after the September 23 deadline for its voluntary offshore compliance initiative to encourage individuals to come in under the terms of that program.

### Workpapers

*Continued from page 1*

workpapers were prepared to support financial filings and gain auditor approval, the court found.

The court observed that there was very little concern here that the taxpayer would be discouraged from soundly preparing for a lawsuit. Any concern was outweighed by the practical problems facing the IRS in uncovering the underreporting of corporate taxes. The IRS had only requested the workpapers after discovering that the taxpayer had entered into potentially abusive transactions. “IRS access serves the legitimate, and important, function of detecting and disallowing abusive tax shelters,” the court concluded.

■ **CCH Comment.** “The court’s discussion of the fairness of allowing the government access to the materials...misses the point,” Kathy Keneally, partner, Fulbright & Jaworski, LLP, New York, told CCH. “The court emphasizes the importance of tax collection by the IRS, but ignores that taxpayers have the right to take positions that the IRS may dispute. Because it may be a court, and not the IRS, that will ultimately decide whether the positions taken on *Textron’s* returns are correct, the need to maintain the work product protection for the analysis done by its advisors is all the more obvious,” she said.

### Dissent

The majority asserted that it was following the “because of” test, a doctrine the First Circuit adopted in *Maine v. Dept. of the Interior*, 298.F.3d 60. According to the dissent, the majority actually overruled that test by basing its decision on whether the workpapers were “prepared for” any litigation or trial and whether they were created “for use” in litigation. These tests, the dissent asserted, were actually narrower than the “because of test.”

Additionally, the dissent argued that because the majority ignored the dual-purpose doctrine, it would allow documents with confidential assessments of litigation strategies and chances of success to flow to litigation adversaries, simply because they were also created for a business purpose in addition to litigation assistance. The dissent reasoned that such a rule would lead to diminishing quality of attorney representation due to attorneys with good faith questions and uncertainties fearful of putting this information in writing.

*References: 2009-2 USTC ¶50,574; TRC IRS: 21,404.*

STANDARD FEDERAL TAX REPORTS (USPS 518000) (ISSN 0162-3494), TOP Edition published weekly, except for the week of Christmas by CCH, a Wolters Kluwer business, 4025 W. Peterson Ave., Chicago, Illinois 60646-6085. Subscription rate \$2,528 per year. Taxes on Parade sold separately, subscription rate \$153 per year for the TOP Edition. Periodicals postage paid at Chicago, Illinois, and at additional mailing offices. **POSTMASTER:** SEND ADDRESS CHANGES TO STANDARD FEDERAL TAX REPORTS, 4025 W. PETERSON AVE., CHICAGO, IL 60646-6085. Printed in U.S.A. All rights reserved. ©2009 CCH. All Rights Reserved.

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