

ALL'S FAIR IN LOVE, WAR, AND TAXES: DOES THE UNITED STATES PROMOTE FAIR TAX COMPETITION IN A GLOBAL MARKETPLACE CONSISTENT WITH EUROPEAN COMMUNITY AND ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT RECOMMENDATIONS THROUGH ITS ADVANCE RULING PROGRAM?

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I. INTRODUCTION

The International Fiscal Association (IFA)¹ defines an "advance ruling" as a legal interpretation and application of an existing law to a proposed or advance transaction requested by a taxpayer in which the issuing revenue authority is bound by the conclusions it provides to the requesting taxpayer.² Applying the IFA definition, advance tax rulings in the United States are statements issued by the Internal Revenue Service (IRS) in response to a taxpayer's request to interpret and apply the Internal Revenue Code (I.R.C.)³ and tax treaties to a proposed transaction, referred to as Private Letter Rulings (PLRs).⁴ Agreements in which the IRS makes factual as well as legal conclusions regarding a proposed transaction between or among related

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1. See generally *What is the IFA?*, available at <http://www.ifa.nl/> (last visited Feb. 20, 2002). The International Fiscal Association (IFA) is a non-governmental, international organization that studies international and "comparative law in regard to public finance, specifically international and comparative fiscal law and the financial and economic aspects of taxation." *Id.*

2. See Maarten J. Ellis, *General Report, in ADVANCE RULINGS*, *Cashiers De Droit Fiscal International LXXXIVb*, at 22-24 (Kluwer ed., 1999) [hereinafter *ADVANCE RULINGS*]. There are several qualifications on this definition: first, the extent to which the ruling must bind the issuer varies; second, advance rulings are not always provided by revenue authorities; and third, the distinction between future and past transactions is penumbral. See *id.* This definition excludes compromises on past transactions, public rulings issued by revenue authorities (classified as those that generally interpret statutes rather than apply to an individual set of facts and were not requested by an individual taxpayer), and approvals for specialized tax treatment granted only after an application is filed by the taxpayer but to which the taxpayer, once satisfying specified conditions, is statutorily entitled. See *id.* These rulings are used to encourage self-assessment, to contribute to good relations between tax administrators and the public, to give certainty to transactions, to consistently apply laws, to minimize controversy and litigation, and to achieve a more coordinated tax system. See *id.*

3. Unless otherwise stated, all statutory references are to the Internal Revenue Code of 1986, as amended, located in Title 26 of the United States Code.

4. See *infra* section II (discussing PLRs).

parties to determine the proper allocation of pricing, known as Advance Pricing Agreements (APAs), are also considered advance agreements in the United States.⁵ Because the procedures governing the program are widely available and consistently applied to all taxpayers, United States advance tax rulings are consistent with the recommendations by the European Community (EC)⁶ and the Organisation for Economic Co-operation and Development (OECD)⁷ to prevent preferential taxing regimes.

To reach this determination, first, PLRs and APAs are defined and the salient features, procedures for requesting and issuing the rulings, the extent of adherence, and whether modifications and revocations are retroactive are discussed.⁸ Second, criteria to evaluate the existence of harmful tax competition contained in the EC Treaty, the EC Code of Conduct, and the OECD Harmful Tax Competition Report as they pertain to advance rulings are reviewed.⁹ The U.S. ruling program is then analyzed to determine whether it is consistent with the EC and OECD guidelines for promoting fair tax competition.¹⁰ In conclusion, through transparency¹¹ and consistency,¹² advance rulings in the United States are consistent with the methods to achieve fair tax competition outlined by the EC and the OECD.¹³

II. PRIVATE LETTER RULINGS (PLRs)

The IRS may issue rulings that apply to specific taxpayers after receiving properly submitted requests. These private rulings interpret particular tax laws and are requested and issued through formal processes, they apply to individual taxpayers and relate to a specific set of facts, they are

5. See *infra* section III (discussing APAs).

6. See *infra* section IV.A for a discussion of the consolidated version of the treaty establishing the European Community, Nov. 10, 1997, O.J. (340) 3, see Consolidated version of the treaty, available at http://europa.eu.int/eur-lex/en/treaties/dat/ec_cons_treaty_en.pdf (last visited Feb. 15, 2002) [hereinafter EC Treaty], and the U.S. advance ruling practice and *infra* section IV.B for a discussion of the EC Code of Conduct and the U.S. advance ruling practice.

7. See *infra* section IV.C for a discussion of the Organisation for Economic Co-Operation and Development, Harmful Tax Comp.: An Emerging Global Issue 11 ¶ 17, available at <http://www.oecd.org/pdf/m00004000/m00004517.pdf> (last visited Feb. 14, 2002) [hereinafter OECD 1998 Report], and the U.S. advance ruling practice.

8. See *infra* section II (PLRs) and *infra* section III (APAs).

9. See *infra* section IV.A.1 (EC Treaty arts. 87-89), *infra* section IV.B.1 (EC Code of Conduct) and *infra* section IV.C.1 (OECD 1998 Report).

10. See *infra* section IV.A.2 (analyzing US ruling practice in accord with EC Treaty arts. 87-89), *infra* section IV.B.2 (analyzing US ruling practice in accord with EC Code of Conduct) and *infra* section IV.C.2 (analyzing US ruling practice in accord with OECD 1998 Report).

11. "Transparency" is the government's openness in revealing both its procedures and the results of agreements and administrative and judicial determinations.

12. This consistency, referred to as "precedence," is the practice of creating a body of administrative and judicial law by basing individual decisions upon similar, previously resolved cases. See BLACK'S LAW DICTIONARY 1176 (6th ed. 1990).

13. See *infra* section V (conclusion).

non-discriminatorily applied, and they are generally disclosed to the public. These characteristics comply with the EC and OECD objectives to promote fair tax competition.¹⁴

The IRS was first authorized to enter into agreements over proposed transactions whenever appropriate, and in the interest of tax administration in 1938.¹⁵ These agreements remain popular both with taxpayers and the IRS because they provide certainty and potentially decreased litigation, improved taxpayer compliance, and increased availability of information in the United States self-assessment tax system.¹⁶

A. Definition and Salient Characteristics of PLRs

PLRs, also referred to as letter rulings, are written statements applying tax laws to proposed transactions that are issued by the IRS National Office to requesting taxpayers when in the best interest of tax administration.¹⁷ Only the requesting taxpayer may rely on the rulings, and only if the actual facts of

14. See *infra* section IV (comparing EC and OECD recommendations with United States tax practices).

15. Rev. Proc. 2002-3, § 2.01, 2002-1 I.R.B. 117. See also Frans Vanistendael, *Legal Framework for Tax*, in TAX LAW DESIGN AND DRAFTING 15, 59 (Victor Thuronyi ed., 1996) (authorizing the Commissioner of Internal Revenue (CIR) to enter into binding agreements with taxpayers over prospective transactions in 1938). Authorization for United States federal tax rulings derives from Congress's conferral of power to the Department of the Treasury (Treasury), an executive agency empowered to promulgate rules and regulations interpreting the Internal Revenue Code (I.R.C.). See generally I.R.C. § 7805(a) (2001) (authorizing Treasury to create regulations to carry out tax laws); Treas. Reg. § 601.201(a) (2001) (authorizing IRS to respond to taxpayer inquiries). Through the Administrative Procedure Act (APA), 5 U.S.C. §§ 551-576, 701-706 (2001), federal administrative agencies (including the IRS) were granted authority to execute their designated functions. However, prior to the APA, the IRS had express authority to create regulations in over 1,338 places in the 1954 Internal Revenue Code. See MICHAEL I. SALTZMAN, IRS PRAC. AND PROC., ¶ 3.03[1] (2d ed. 1991) (referring to authority in I.R.C. for IRS to promulgate regulations); Vanistendael, *supra*, at 59 (explaining statutory delegation of authority to the IRS to issue regulations implementing tax law in the Administrative Procedure Act and in I.R.C. statutes). The Treasury re-delegated the authority to respond to "inquiries of individuals and organizations 'whenever appropriate in the interest of sound tax administration' about the tax effects of their acts or transactions or about their status for tax purposes" to the IRS. SALTZMAN, *supra*, ¶ 3.03[1] (quoting Treas. Reg. § 601.201(a)). The Statement of Procedural Rules in subchapter H of the Code of Federal Regulations is the principal source for the IRS's authority. See Treas. Reg. §§ 601.101 through 601.901; see also Rev. Proc. 2002-1, 2002-1 I.R.B. 1 through Rev. Proc. 2002-8, 2002-1 I.R.B. 252.

16. ADVANCE RULINGS, *supra* note 2, at 25 (increasing complexity of tax statutes worldwide contributes to increase in advance rulings); see also Jason Chang et al., *Private Income Tax Rulings: A Comparative Study*, 10 TAX NOTES INT'L 738, 738 (1995) (growing complexity of tax legislation combined with increasing reliance on self-assessment and "after-the-fact review by taxation authorities" have increased rulings).

17. See Rev. Proc. 2002-1 §§ 2.01, 3.00, 2002-1 I.R.B. 1; Treas. Reg. § 601.201(a)(2) (2001). References to "National Office" are to the division Offices of Associate Chief Counsel. See Rev. Proc. 2002-1 § 1, 2002-1 I.R.B. 1.

the transactions for which the rulings were requested are substantially the same as those presented in the ruling requests.¹⁸ As a matter of policy and practice, IRS District Offices bind themselves to the conclusions stated in PLRs. The IRS, however, is only legally required to adhere to PLRs to the extent that they accompany closing agreements under section 7121.¹⁹

B. Procedure for Requesting PLRs

A taxpayer initiates the process to obtain a PLR by submitting a written request, supporting documentation, and a user fee. A request must contain a statement and analysis of material facts,²⁰ true copies²¹ of relevant documents²² and applicable foreign laws,²³ a discussion of whether issues have been considered

18. Compare I.R.C. § 6110(k)(3) (2001) ("Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent."); Treas. Reg. § 301.6110-7(b) (2001) (substantially similar); David R. Webb Co. v. Comm'r, 708 F.2d 1254, 1257 n.1 (7th Cir. 1983) ("[PLRs] may not be used or cited as precedent."); Estate of Reddert v. United States, 925 F. Supp. 261, 267 (D.N.J. 1996) (PLRs and TAMs "reveal the interpretation put upon the statute by the agency charged with the responsibility of administering revenue laws and may provide evidence that such construction is compelled by language of statute.") (internal citations omitted); MARVIN J. GARBIS ET AL., TAX PROCEDURE AND TAX FRAUD CASES AND MATERIALS 67 (3d ed. 1992) (providing that, although only the taxpayer to whom the letter ruling was issued may rely on it, in practice they are often referred to for their insight into the IRS's position on many issues).

19. See Treas. Reg. § 601.201(a)(2) (2001); Rev. Proc. 2002-1, §§ 2.01, 12.04, 2002-1 I.R.B. 1. See *infra* section II.E (discussing PLR modification and revocation).

20. See Rev. Proc. 2002-1, § 8.01(1), 2002-1 I.R.B. 1. Each request for a letter ruling must contain a complete statement of facts to identify and describe the transaction including: the identifying information of all interested parties to the transaction (such as names, addresses, telephone numbers, and taxpayer identification numbers), the annual accounting period and methods used for maintaining books and filing taxes, a description of the taxpayer's business operations, the business reasons for the transaction, and a description of the transaction. See *id.* Any additional facts material to the ruling must be specifically stated and not incorporated by reference to attached documents or paperwork previously submitted; an analysis of their bearing to the requested ruling must also be included. See *id.* § 8.01(3).

21. See Rev. Proc. 2002-1 § 8.01(2)(a), 2002-1 I.R.B. 1. A true copy is a duplicate that clearly reflects the original document and that is easily understood to be a duplicate of the original. See BLACK'S *supra* note 12, at 1508. Original documents should not be submitted because they will become part of the IRS's file and will not be returned to the taxpayer. See Rev. Proc. 2002-1 at § 8.01(2)(a), 2002-1 I.R.B. 1.

22. See *id.* Relevant documents include "contracts, wills, deeds, agreements, instruments, trusts documents, proposed disclaimers, and other documents pertinent to the transaction." *Id.* Each document should be sufficiently labeled and attached to the request in alphabetical order. See *id.*

23. See Rev. Proc. 2002-1 § 8.01(2), 2002-1 I.R.B. 1. Statutes, regulations, administrative pronouncements, or other legal authority included "must be copied from an official publication of the foreign government or another widely available, generally accepted publication" (identifying the title and date of the publication, including updated supplements). *Id.* All paperwork must be submitted in English. See *id.* If the original document is not in English, a certified translation along with a true copy of the non-English document must be included. See *id.* § 8.01(2)(a). The translation must be performed by and attested to by a

in an earlier return, ruling, or request for ruling,²⁴ a statement of authority both in support of and contrary to the taxpayer's position,²⁵ and a statement identifying pending litigation. The request must include a deletion statement,²⁶ signature,²⁷

qualified translator. *See id.* § 8.01(2)(c). The attestation must contain statements that the translation is true and accurate, that the translator is qualified to translate income tax matters, and include the attesting person's name and address. *See id.*

24. *See Rev. Proc. 2002-1 § 8.01(4), 2002-1 I.R.B. 1.* The taxpayer or the taxpayer's representative must make an affirmative statement to the best of his or her knowledge attesting to whether the same issue upon which the ruling is sought was present in an earlier tax return of the taxpayer or related party and whether the issue is being, or has been considered by the IRS. *See id.* § 8.01(4)-(5), 2002-1 I.R.B. 1. If this issue is being or has been considered, then the taxpayer must also clarify whether the issue was resolved and, if so, in what manner. *See id.* § 8.01(4). If the ruling request requires the interpretation of an income or estate tax treaty, then the taxpayer must disclose whether a request for a ruling or closing agreement has been submitted to the tax authority in the treaty country on the same or similar issue for the taxpayer (or related party) and the outcome of the request. *See id.* § 8.01(6). If the taxpayer believes or has knowledge of a related ruling request, he or she must provide the IRS with identifying information (including the dates the request was submitted). *See id.* § 8.01(5).

25. *See Rev. Proc. 2002-1 § 8.01(8) (supporting), (9) (opposing), 2002-1 I.R.B. 1.* These statements should explain the grounds for the conclusion (citing relevant authorities, including legislation or proposed legislation, tax treaties, court decisions, regulations, notices, revenue rulings, revenue procedures, or announcements). *See id.* Even if not advocating a particular outcome, a statement containing the taxpayer's views for the transaction and legal authority must be included. *See id.* The purpose for doing so is to assist the IRS in understanding the issue and the relevant authorities and to, therefore, respond to the request expeditiously. *See id.* If the taxpayer determines that there are no contrary authorities then an attachment stating such should be included in the request. *See id.* § 8.01(9).

26. *See Rev. Proc. 2002-1 § 8.01(11), 2002-1 I.R.B. 1.* The request for a PLR must include a statement of information the taxpayer proposes to be deleted from the letter ruling that is disclosed to the public, referred to as a "deletions statement." *See id.* The general rule of section 6110 (authorizing the disclosure of the text of any written IRS determination to be available for public review) applies to PLRs. *See I.R.C. § 6110(a) (2001).* *See also infra* section II.I (discussing disclosure and section 6110). Before releasing this information for public review, the IRS deletes the taxpayer's identifying information based on the taxpayer's deletion statement. *See Rev. Proc. 2002-1 § 8.01(11).* The format for submitting the deletions statement is specific. *See id.* § 8.01(11)(a)-(c). After the IRS determines what information will be redacted, it sends the taxpayer a notice stating its intention to disclose the material and a copy of the version proposed for public review. *See id.* § 8.01(11)(e) (citing I.R.C. § 6110(f)(1)). To protest the proposed deletions, the taxpayer must send a written response to the IRS within 20 days of the date of the notice and a copy of the PLR with the proposed deletions enclosed in brackets. *See id.* Within 20 calendar days of receiving the protest, the IRS will mail its administrative conclusion to the taxpayer. *See id.* The taxpayer has no right to a conference to resolve any disagreements regarding the redactions from the text of the PLR. *See id.* As a general rule, the IRS will not consider deleting material that was not proposed to be deleted before the IRS issued the letter ruling. *See id.* Because disclosure of the underlying transaction for which advice is sought in a PLR may be adverse to the taxpayer for business purposes, a taxpayer may receive permission from the CIR to conceal the information until the underlying transaction is complete. *See id.*

27. *See Rev. Proc. 2002-1 § 8.01(12), 2002-1 I.R.B. 1.* The taxpayer or the taxpayer's authorized representative must sign and date the request for a letter ruling. *See id.* "A stamped signature is not permitted." *Id.*

and penalty of perjury statement.²⁸ Finally, the taxpayer must complete and submit the checklist provided by the IRS.²⁹ The amount of the user fee is \$600, \$1,200 or \$6,000 depending on the transaction proposed but may be reduced based upon the taxpayer's gross income.³⁰

Completed requests are submitted to the appropriate division of the Associate Chief Counsel or Division Counsel/Associate Chief Counsel and marked "RULING REQUEST SUBMISSION."³¹ Once the request has been submitted (but before the letter ruling has been issued), the taxpayer has an affirmative duty to notify the IRS National Office of circumstances affecting the determination of the ruling or of a related examination.³²

C. Processing of a PLR Request by the IRS National Office

The Technical Services staff of the Associate Chief Counsel for Procedure and Administration receives and processes PLR requests by accepting the user fee and forwarding the completed applications to the appropriate Chief Counsel division.³³ Within twenty-one days of receiving the request, an IRS representative contacts the taxpayer to discuss procedural and

28. See Rev. Proc. 2002-1 § 8.01(15)(a), 2002-1 I.R.B. 1. A letter ruling request or changes in the request must be accompanied by the following penalties of perjury statement:

Under penalties of perjury, I declare that I have examined [Insert, as appropriate: this request or this modification to the request], including accompanying documents, and, to the best of my knowledge and belief, [Insert, as appropriate: the request or the modification] contains all the relevant facts relating to the request, and such facts are true, correct, and complete.

Id. (bracketed material in original). The declaration must be signed and dated by the taxpayer, not the taxpayer's representative. See *id.* § 8.01(15)(b). A person who signs on behalf of a corporate taxpayer must be an officer of the corporation with personal knowledge of the facts submitted in the request and whose duties expand beyond obtaining a letter ruling from the IRS. See *id.* The signor for a trust, partnership, or limited liability company must have personal knowledge of the facts submitted. See *id.*

29. See Rev. Proc. 2002-1, 1 I.R.B. at app. C. These materials are published to assist the taxpayer in preparing PLR requests and to expedite processing the ruling. See *id.*

30. See Rev. Proc. 2002-1 § 15.05 (user fee), app. A(2)(a-d) (same), 2002-1 I.R.B. 1. The fees may be reduced to \$500 if the request concerns a personal tax issue of an individual taxpayer and his or her gross income is less than \$250,000 or pertains to a business tax issue and the taxpayer's gross income is less than \$1,000,000. See *id.* at app. A (A)(4)(a)-(b). These fees are also reduced if the rulings are additional requests that are substantially the same as those previously requested for another entity in a control group. See *id.* at app. A (A)(5).

31. See Rev. Proc. 2002-1 § 8.03(1), 2002-1 I.R.B. 1. Generally, only the actual request for a PLR (with no additional copies) must be submitted to the IRS. See *id.* § 8.06.

32. See Rev. Proc. 2002-1 § 8.04, 2002-1 I.R.B. 1.

33. See Rev. Proc. 2002-1 § 10.01, 2002-1 I.R.B. 1. The application is then assigned to a branch of the Chief Counsel division. See *id.*

substantive issues.³⁴ If additional information is required, the IRS will close the request unless the information is received within twenty-one days.³⁵

Generally, after the conference of right but before the PLR is issued, the branch representative informs the taxpayer of the IRS's conclusions.³⁶ No informal opinion can bind the IRS or be relied upon by a taxpayer as a basis for obtaining retroactive relief under section 7805(b).³⁷ If the IRS intends to rule adversely, the taxpayer is given the opportunity to withdraw the PLR request.³⁸ If it is not promptly withdrawn, the adverse ruling will be issued.³⁹

Although the IRS is not restricted to a specified amount of time within which rulings must be issued, there is a general consensus that requests should be processed and PLRs issued as soon as practicable.⁴⁰ To facilitate this goal, timeframes within which specified actions must be completed by either the IRS or the taxpayer are provided.⁴¹ Additionally, the taxpayer may submit a

34. See Rev. Proc. 2002-1 § 10.02, 2002-1 I.R.B. 1. Examples of procedural or substantive issues discussed include whether a ruling recommendation will be favorable to the taxpayer; whether the IRS needs additional information; and whether, given the nature of the transaction, a conclusion can be made. See *id.* §10.02 (1)-(3). If the ruling request involves issues within the jurisdiction of another branch or office, then those issues will be referred to the appropriate branch and the initial IRS representative who received the request will inform the taxpayer of such. See *id.* § 10.03. The representative from the other branch will also contact the taxpayer within twenty-one days to discuss any related procedural and (to the extent possible) substantive issues. See *id.*

35. See Rev. Proc. 2002-1 § 10.06(1), (3), 2002-1 I.R.B. 1. If minor issues prevent the IRS representative from providing a favorable ruling recommendation then the representative will discuss minor changes in the transaction or adherence to certain published positions with the taxpayer that, if followed, would result in a favorable ruling recommendation. See *id.* § 10.04.

36. See Rev. Proc. 2002-1 § 10.08, 2002-1 I.R.B. 1.

37. See Rev. Proc. 2002-1 § 10.05, 2002-1 I.R.B. 1.

38. See Rev. Proc. 2002-1 § 10.08, 2002-1 I.R.B. 1. A taxpayer may withdraw a PLR request at any time before the IRS signs it. See *id.* § 8.07. Similarly, the IRS may refuse to issue a PLR. See *id.* If either occurs and the taxpayer has not submitted a statement that the transaction is being abandoned, then the IRS National Office will generally send a memorandum to the appropriate official in the operating division with examination jurisdiction of the taxpayer's return. Compare *id.* § 8.07(2)(b) (emphasis added), in which the National Office representative "generally will notify" the appropriate official in the examination division within the taxpayer's jurisdiction of withdrawn or otherwise un-issued letter rulings with *id.* § 8.07(2)(a), in which the IRS National Office representative "will notify" the appropriate official in the examination division within the taxpayer's jurisdiction of withdrawn or otherwise un-issued PLR ruling requests pertaining to changes to or from an improper accounting method. If the memorandum explains information beyond that the request was withdrawn and that the National Office was tentatively adverse to the underlying transaction, or that the National Office declined to grant a PLR, then the memorandum constitutes Chief Counsel Advice and is subject to public review. See *id.* § 8.07(2)(c), 2002-1 I.R.B. 1 (citing I.R.C. § 6110). The user fee to submit a PLR request is not refunded if the taxpayer withdraws the request. See *id.* § 10.08.

39. See Rev. Proc. 2002-1 § 10.08, 2002-1 I.R.B. 1.

40. A representative of the IRS will not provide an actual or estimated date by which a ruling will be issued.

41. See, e.g., *supra* notes 34-35 and accompanying text (imposing timeframe during which IRS and taxpayer must contact one another).

proposed draft of the ruling,⁴² an expedited review request,⁴³ or a two-part ruling request,⁴⁴ which may accelerate the ruling process. However, rulings are seldom obtained within three months of submitting a request and most are issued between three to six months after the request is received.⁴⁵ Requests involving complex transactions or novel issues may take between six months to a year or more to obtain a PLR.⁴⁶

Once the PLR is issued, the IRS National Office sends a copy to the operating division with examination jurisdiction over the taxpayer's return.⁴⁷

D. Taxpayer Conferences with the IRS

Although taxpayers are entitled to a conference of right to discuss their PLR request with the IRS, they may also ask for a conference to discuss substantive or procedural issues related to the contemplated requests.

The taxpayer's conference of right occurs after the IRS branch has had an opportunity to study the case.⁴⁸ At the conference, the taxpayer meets with two IRS personnel: a branch representative who explains the IRS's tentative position on the substantive issues of the request and a representative

42. See Rev. Proc. 2002-1 § 10.09, 2002-1 I.R.B. 1. Proposed drafts are based on discussions of the issues between the taxpayer and the IRS. *See id.* The IRS can provide a sample format of the letter ruling. *See id.* The proposed draft should include a discussion of the facts, analysis, and letter ruling language to be included. *See id.* The draft should also be submitted electronically. *See id.* Submitting a proposed draft is not required to receive a ruling. *See id.*

43. See Rev. Proc. 2002-1 § 8.02(4), 2002-1 I.R.B. 1. The IRS ordinarily processes ruling requests in the order that they are received. *See id.* However, expedited review may be granted (although rare) after a written request setting forth details substantiating the need for priority review. *See id.* The request for processing ahead of the regular order will only be granted to taxpayers with a compelling need that was outside of the taxpayer's control and create a real business need to obtain a ruling to prevent detrimental and significant consequences. *See id.* The taxpayer must demonstrate that the cause necessitating expedited review could not be reasonably anticipated or controlled, and that the ruling request was submitted as soon as practicable after becoming aware of the deadline. *See id.* If expedited review is granted, the IRS cannot assure that the PLR will be processed by the date requested. *See id.*

44. See Rev. Proc. 2002-1 § 8.02(3), 2002-1 I.R.B. 1. A two-part PLR request sets forth the statement of facts and related documents required (part one) and a summary of facts the taxpayer believes are controlling in reaching the desired conclusion (part two). *See id.* If the IRS accepts this statement of controlling facts, then the PLR is generally based on these facts, which are incorporated into the ruling. *See id.* Where this procedure is allowed, it is encouraged because the time necessary to process the request is reduced. *See id.*

45. See ADVANCE RULINGS, *supra* note 2, at 635.

46. *See id.*

47. See Rev. Proc. 2002-1 § 10.11, 2002-1 I.R.B. 1.

48. See Rev. Proc. 2002-1 § 11.02, 2002-1 I.R.B. 1. The taxpayer may request, however, that the conference be earlier. *See id.*

authorized to bind the agency to a ruling.⁴⁹ At the conference, neither representative may commit the IRS, and the taxpayer may not appeal the action of a branch.⁵⁰ Although held at the IRS National Office, the conference is informal and therefore may not be recorded.⁵¹

As noted above, the taxpayer may request a conference with the IRS prior to submitting a request for a PLR to discuss the substantive or procedural issues related to a proposed transaction.⁵² The IRS will only grant such a request if the identity of the taxpayer is disclosed, a PLR request is actually intended, the request concerns an issue over which PLRs are normally issued, and time permits.⁵³ If the taxpayer does not submit a request for a PLR after a pre-submission conference, then the IRS division with jurisdiction to audit the taxpayer is notified of the issues that were raised during the meeting.⁵⁴

E. Retroactive Revocation of a PLR

Although in practice IRS district offices respect and adhere to PLRs, the IRS is only legally bound by rulings accompanied by closing agreements under section 7121.⁵⁵ Therefore, technically, the IRS has the discretion to modify or revoke a PLR anytime it finds the ruling erroneous or in discord with its current position on an issue.⁵⁶

49. See Rev. Proc. 2002-1 § 11.02, .04, 2002-1 I.R.B. 1. The most senior IRS representative also ensures that the taxpayer is given an opportunity to present his or her views on all issues. See *id.* §11.04.

50. See Rev. Proc. 2002-1 § 11.02, .04, 2002-1 I.R.B. 1. After the conference of right, the IRS will offer the taxpayer an additional conference if it proposes an adverse ruling either on a new issue or on grounds different than those discussed at the earlier conference. See *id.* § 11.05.

51. See Rev. Proc. 2002-1 § 11.02, .03, 2002-1 I.R.B. 1. A taxpayer may request that the conference of right occur via telephone rather than in Washington, D.C. (where the IRS National Office is located). See *id.*

52. See Rev. Proc. 2002-1 § 11.07, 2002-1 I.R.B. 1. A pre-submission conference may be requested over the telephone or in writing. See *id.* Requests should identify the taxpayer, and include a brief explanation of the primary issue so that the IRS can assign the conference to the appropriate branch. See *id.*

53. See Rev. Proc. 2002-1 § 11.07, 2002-1 I.R.B. 1. Three days before the pre-submission conference, the taxpayer is usually required to submit a statement of whether the issue to be discussed in the pre-submission conference is one that is normally addressed in a PLR, and a draft of the PLR request or another detailed written statement of the proposed transaction that includes the issue and the taxpayer's legal analysis. See *id.*

54. See *id.*

55. See SALTZMAN, *supra* note 15, ¶ 3.03[6][c].

56. See Rev. Proc. 2002-1 § 12.04, 2002-1 I.R.B. 1; see also SALTZMAN, *supra* note 15, ¶ 3.03[6][c]. Any revocation or modification "applies to all years open under the period of limitations unless the [IRS] uses its discretionary authority under [section] 7805(b) to limit the retroactive effect of the revocation or modification." Rev. Proc. 2002-1 § 12.04, 2002-1 I.R.B. 1.

A letter ruling may be revoked or modified due to: (1) a notice to the taxpayer to whom the letter ruling was issued; (2) the enactment of legislation or ratification

This result is mitigated by the taxpayer's opportunity to initiate a judicial proceeding to determine whether the IRS's exercise of discretion was rationale and supported by relevant consideration. If the result was not, then the courts are empowered to change that result.⁵⁷

In practice, the IRS applies revocations or modifications retrospectively only in rare and unusual circumstances.⁵⁸ In general, a taxpayer is afforded the benefit of prospective (and not retrospective) changes or revocations if there were no omissions or misstatements of material fact in the request; the facts of the actual, underlying transaction do not materially differ from those submitted in the request; there has been no change in applicable law;⁵⁹ the ruling was originally issued on a proposed transaction; and there has been good faith reliance on the PLR, resulting in a detriment to the taxpayer if the change or revocation is retroactive.⁶⁰

Under section 7805(b), the IRS may prescribe the extent to which a revocation or modification of a letter ruling will be applied without retroactive effect. Accordingly, a taxpayer to whom a letter request has been issued may request that its retroactive effect be limited.⁶¹ If such a request is made, then the taxpayer must state that the request is being made under section 7805(b), the relief sought, why the relief requested should be granted and include any documents bearing on the request.⁶²

of a tax treaty; (3) a decision of the United States Supreme Court; (4) the issuance of temporary or final regulations; or (5) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin.

Id. "Publication of a notice of proposed rulemaking will not affect the application of [a PLR] issued under this revenue procedure." *Id.* If a PLR is revoked or modified retroactively by another PLR then it will state the grounds upon which the retroactive revocation or modification was based unless the taxpayer engaged in fraud. *See id.* § 12.05.

57. 1 MERTENS LAW OF FEDERAL INCOME TAXATION § 3.105 (Martin M. Weinstein et al. eds., 1985 & Supp. 2002) (discussing the requirement that retroactively applied PLRs must treat taxpayers similarly). An abuse of discretion was found where the IRS revoked a PLR although the conditions for revoking PLRs, as stated in its revenue procedure, were not met. *Id.* (citing Presbyterian & Reformed Pub. Co. v. Comm'r, 79 T.C. 1070, 1089 (1982); Capital Federal Savings & Loan Ass'n v. Comm'r, 96 T.C. 204 (1991)).

58. *See* Treas. Reg. § 601.201(l)(5) (2001).

59. *See generally* Dixon v. United States, 381 U.S. 68 (1965); Automobile Club v. Comm'r, 353 U.S. 180, 184 (1957). Retroactive corrections of mistakes in law in PLRs are permitted (but are subject to an abuse of discretion standard) because an erroneous statement of law is without legal effect; only Congress is empowered to create tax laws, not the Commissioner. *See id.*

60. *See* Treas. Reg. § 601.201(l)(5); Rev. Proc. 2002-1 § 12.05(1)-(5), 2002-1 I.R.B. 1. These are the general conditions used to analyze whether the Commissioner commits an abuse of discretion under section 7805(b). *See* SALTZMAN, *supra* note 15, ¶ 3.03[6][c].

61. *See* Rev. Proc. 2002-1 § 12.11, 2002-1 I.R.B. 1.

62. *See* Rev. Proc. 2002-1 § 12.11(01)(a)-(d), 2002-1 I.R.B. 1.

F. Limitations on Ruling Areas

Ruling areas can be categorized into the following classes: no ruling, not ordinarily issued, and temporarily not issued,⁶³ and are further distinguished by general restrictions within those categories and by particular topics. General distinctions are made within these classes as well as those based on particular topics within those classes.

1. No ruling areas

Taxpayers may request PLRs on issues within the jurisdiction of each of the divisions of the Associate Chief Counsel.⁶⁴ However, the IRS does not issue rulings where the problems involved are inherently factual or when doing so is not in the interest of sound tax administration.⁶⁵ In addition, the IRS will not issue a ruling on a transaction, regardless of the topic, that contains: alternatives to a proposed transaction,⁶⁶ frivolous issues,⁶⁷ unresolved employment relationship determinations,⁶⁸ issues in which the government has not exhausted its right to appeal,⁶⁹ proposed transactions that would subject the taxpayer to a criminal penalty⁷⁰ or that lack a bona fide

63. In addition to the restrictions discussed *infra*, letter rulings will not be issued in areas covered by automatic approval procedures. See Rev. Proc. 2002-3 § 6.01-.06, 2002-1 I.R.B. 117 (listing automatic approval procedures).

64. See Rev. Proc. 2002-1 § 3, 2002-1 I.R.B. 1. Procedures for obtaining PLRs that apply to alcohol, tobacco, and firearm taxes under subtitle E of the I.R.C. are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms (ATF). See Rev. Proc. 2002-1 § 4.01, 2002-1 I.R.B. 1.

65. See generally Rev. Proc. 2002-1 § 7.01, 2002-1 I.R.B. 1; Rev. Proc. 2002-3 §§ 2.01, 3.02, 2002-1 I.R.B. 117; Rev. Proc. 2002-7 § 2.01, 2002-1 I.R.B. 249. "Inherently factual" issues include those where, under I.R.C. procedure, a factual determination of "reasonable cause, due diligence, good faith, clear and convincing evidence, or other similar terms" is necessary. Rev. Proc. 2002-3 § 3.02(4), 2002-1 I.R.B. 117.

66. See Rev. Proc. 2002-1 § 7.02, 2002-1 I.R.B. 1; Rev. Proc. 2002-3 § 3.02(3), 2002-1 I.R.B. 117. This restriction likely exists because, by submitting alternative transactions in the request, the taxpayer is submitting multiple ruling requests in the form of a single request, and therefore is requesting tax planning advice. See *id.*

67. See Rev. Proc. 2002-3 § 3.02(9), 2002-1 I.R.B. 117; Rev. Proc. 2002-1 § 7.04, 2002-1 I.R.B. 1. "Frivolous issues" are defined as those without a factual or legal basis, or determined as frivolous by the courts. See *id.* For example, whether the requirement of filing a tax return is an unreasonable search prohibited by the United States Constitution, whether income taxes are voluntary, and whether refusing to pay taxes is permitted because the taxpayer opposes government expenditures are frivolous issues. See *id.*

68. See Rev. Proc. 2002-3 § 3.02(7), 2002-1 I.R.B. 117. The IRS will not issue PLRs about which an entity is considered an employer of a worker under common law employer-employee relationship rules when more than one entity is treating the worker as such. See Rev. Proc. 2002-1 § 1.06, 2002-1 I.R.B. 1.

69. See Rev. Proc. 2002-3 § 3.02(2), 2002-1 I.R.B. 117.

70. See Rev. Proc. 2002-3 § 3.02(5), 2002-1 I.R.B. 117.

business purpose,⁷¹ or any incomplete or non-conforming request.⁷² Under the jurisdiction of the Associate Chief Counsel (International), the issuance of PLRs is also restricted where: the estate tax is prospectively applied to the property or the estate of a living person, an issue is clearly and adequately addressed by another authority (absent extraordinary circumstances), and any issue that is the subject of the taxpayer's pending request for competent authority assistance under a United States Tax Treaty.⁷³ Finally, PLRs are only issued on partial transactions if the remaining portions of the transaction falls within a specific no ruling area.⁷⁴

The IRS also refuses to issue PLRs on certain topics. Within the jurisdiction of the Associate Chief Counsel (International), these topics address: original issue discount, income affected by a treaty, foreign base company income, and dual consolidated losses.⁷⁵

2. "Not ordinarily" issued⁷⁶

PLRs will not ordinarily be issued when the underlying transaction contemplates whether a business purpose exists or whether a taxpayer uses a correct classification code, contradicts United States tax law designed to effectuate different tax consequences under the tax laws of the United States and of a foreign country, concerns a taxpayer domiciled in a foreign jurisdiction with which the United States does not have an effective mechanism for obtaining tax information relevant to the ruling request,⁷⁷ considers proposed federal, state, local, municipal, or foreign legislation,⁷⁸ or interprets foreign law or documents beyond their plain meaning.⁷⁹

Areas over which rulings are not ordinarily issued that are within the ambit of the remaining, combined Associate Chief Counsel Offices include

71. See Rev. Proc. 2002-3 § 3.02(1), 2002-1 I.R.B. 117. Transactions designed primarily to reduce taxes do not have a bona fide business purpose. See *id.*

72. See Rev. Proc. 2002-3 § 3.02(6), 2002-1 I.R.B. 117.

73. See Rev. Proc. 2002-7 § 3.02(1)-(7), 2002-1 I.R.B. 249. See *infra* section III.F (discussing consideration of APAs by competent authority).

74. See Rev. Proc. 2002-1 § 7.03, 2002-1 I.R.B. 1. Note that *determination* letters may be issued on partial transactions. See *id.* If a taxpayer submits a PLR request on a partial transaction attesting that the remainder of the transaction falls within a no ruling area, then the taxpayer must state the tax treatment of the no rule tax issue in the request to the best of the taxpayer's knowledge and belief. See Rev. Proc. 2002-3 § 2.03, 2002-1 I.R.B. 117.

75. See Rev. Proc. 2002-7 § 3.01(1)-(4), 2002-1 I.R.B. 249.

76. See Rev. Proc. 2002-3, §§ 1.00, 4.01(1), 2002-1 I.R.B. 117. "Unique and compelling reasons must be demonstrated" for a PLR that is characterized as "not ordinarily" issued to overcome this classification and to be issued. *Id.*

77. See Rev. Proc. 2002-3 § 4.02(7), 2002-1 I.R.B. 117; Rev. Proc. 2002-7 § 4.02(5), 2002-1 I.R.B. 249.

78. See Rev. Proc. 2002-7 § 4.02(5), 2002-1 I.R.B. 249.

79. See Rev. Proc. 2002-7 § 4.02(6)(a), 2002-1 I.R.B. 249.

those in which: interrelated items, sub-methods of accounting,⁸⁰ or indefinite consummation dates for underlying transactions exist;⁸¹ properties are held primarily for sale in the ordinary course of a trade or business;⁸² or litigation by affected parties concerning the underlying transactions is contended.⁸³ In addition, the IRS will not ordinarily address questions and problems in PLRs regarding specific code provisions (generally because they require largely factual determinations).⁸⁴

3. "Temporarily not issued" ruling areas

Rulings will not be issued for a temporary period in specified areas that are under extensive study.⁸⁵ These issues currently include: salary reimbursement arrangements,⁸⁶ deferred compensation plans for state and local governments and tax-exempt organizations,⁸⁷ undivided fractional interests in real property,⁸⁸ defining a small business corporation,⁸⁹ and determining the identity of a disregarded employer.⁹⁰

G. Effect of a Favorable, Adverse, or Withdrawn Ruling

"A taxpayer may not rely on a [PLR] issued to another taxpayer."⁹¹ When determining a taxpayer's tax liability, the director must determine whether the transaction executed was the transaction proposed in the ruling request, whether the conclusions stated in the PLR are accurately reflected in the taxpayer's tax return, and whether there has been any change in the applicable law during the period in which the transactions occurred.⁹² If the

80. See Rev. Proc. 2002-3 § 4.02(3), 2002-1 I.R.B. 117.

81. See Rev. Proc. 2002-3 § 4.02(4), 2002-1 I.R.B. 117.

82. See Rev. Proc. 2002-3 § 4.02(5), 2002-1 I.R.B. 117.

83. See Rev. Proc. 2002-3 § 4.02(6), 2002-1 I.R.B. 117.

84. See Rev. Proc. 2002-3 § 4.02(1), 2002-1 I.R.B. 117; Rev. Proc. 2002-7 § 4.01(1)-(29), 2002-1 I.R.B. 249.

85. See Rev. Proc. 2002-3 §§ 2.02, 5.00, 2002-1 I.R.B. 117. These advance rulings will be issued again once the Treasury or IRS announces their resolution in revenue rulings, revenue procedures, or regulations. See *id.*

86. See Rev. Proc. 2002-3 § 5.01, 2002-1 I.R.B. 117.

87. See Rev. Proc. 2002-3 § 5.02, 2002-1 I.R.B. 117. Specifically, a PLR will not be issued on the tax treatment of any section 457 plan providing that a loan may be made from assets held by such plan to any participants or beneficiaries under the plan. See *id.*

88. See Rev. Proc. 2002-3 § 5.03 (regarding eligibility for tax-free exchanges), § 5.06 (concerning whether arrangements constitute a separate taxable entity), 2002-1 I.R.B. 117.

89. See Rev. Proc. 2002-3 § 5.04, 2002-1 I.R.B. 117. The specific issue under review is whether a state law limited partnership electing under Treas. Reg. 301.7701-3 to be classified as an association taxable as a corporation has more than one class of stock for purposes of section 1361(b)(1)(D). See *id.*

90. See Rev. Proc. 2002-3 § 5.05, 2002-1 I.R.B. 117.

91. Rev. Proc. 2002-1 § 12.02, 2002-1 I.R.B. 1.

92. See Rev. Proc. 2002-1 § 12.03(1)-(4), 2002-1 I.R.B. 1.

director determines that a PLR should be revoked or modified, this determination is forwarded to the IRS National Office for review before the director takes further action.⁹³ A taxpayer may protest an adverse PLR under section 367(a)(1) within forty-five days.⁹⁴

H. User Fee Requirements for a PLR

The Secretary of the Treasury is vested with the authority to establish user fees paid for taxpayers in exchange "for requests to the [Internal Revenue] Service for letter rulings, opinion letters, determination letters, and similar requests."⁹⁵ The fees, payable in advance, apply to requests made between February 1, 1988 and October 1, 2003 and vary depending on the time and difficulty associated with fulfilling taxpayers' requests for these rulings.⁹⁶

Requests involving several unrelated transactions or requests about a related transaction by separate entities are treated as separate requests and separate fees apply to each.⁹⁷ User fees are reduced for PLR requests that are substantially identical to rulings previously issued by the IRS.⁹⁸ The user fee

93. See Rev. Proc. 2002-1 § 12.03, 2002-1 I.R.B. 1. If the director determines that the transaction and the ruling are consistent and there has been no change in the law affecting the taxpayer, then the PLR is to be applied by the director to determine the taxpayer's liability. See *id.*

94. See Treas. Reg. § 601.201(e)(19). The Assistant Commissioner (Technical) will establish an ad hoc advisory board to consider each protest, regardless of whether a conference is requested. See *id.* The taxpayer will be granted one conference upon request. See *id.* The board will consider all materials submitted in writing by the taxpayer and oral arguments presented at the conference. See *id.* The Board will make its recommendation to the Assistant Commissioner (Technical), who will make the decision. See *id.* See also Rev. Proc. 77-5(4) (providing procedures for taxpayer to protest an adverse PLR).

95. Rev. Proc. 2002-1 § 15.01, 2002-1 I.R.B. 1 (citing § 10511 of the Revenue Act of 1987, 1987-3 C.B. 1, 166 enacted Dec. 22 1987, as amended by § 11319 of the Omnibus Budget Reconciliation Act of 1990, 1991-2 C.B. 481, 511, enacted Nov. 5, 1990, by § 743 of the Uruguay Round Agreements Act, 1995-1 C.B. 230, 239, enacted Dec. 8, 1994, and by § 2 of the Tax Benefits for Individuals Performing Certain Services in Certain Hazardous Duty Areas, 1996-3 C.B. 1, enacted March 20, 1996). "Similar requests" include APAs and certain closing agreements. See *id.* § 15.02. User fees do not apply to filing for certain elections, information letters, or requests to change a taxpayer's accounting period or method that is permitted by a published automatic change revenue procedure. See Rev. Proc. 2002-1 § 15.03(1)-(4), 2002-1 I.R.B. 1. Nor are user fees imposed upon departments, agencies, or instrumentalities of the United States that certify that they are seeking a PLR or determination letter on behalf of a program or activity funded with federal appropriations or on requests as to whether a worker is an employee for federal employment taxes and income tax withholding. See *id.* § 15.04(1)-(2); Rev. Proc. 2002-8 § 4.03, 2002-1 I.R.B. 252.

96. See Rev. Proc. 2002-1 § 15.01, 2002-1 I.R.B. 1.

97. See Rev. Proc. 2002-1 § 15.06(4), (5), 2002-1 I.R.B. 1.

98. See Rev. Proc. 2002-1 § 15.07(2), 2002-1 I.R.B. 1.

will generally only be refunded if the IRS refuses to rule on all issues for which a ruling is requested.⁹⁹

I. Disclosure of PLRs

There are three primary authorities controlling the disclosure of taxpayer information and administrative materials promulgated by the IRS: section 6110, the general rule authorizing disclosure; section 6103, the exception limiting disclosure; and, although largely historical, the Freedom of Information Act (FOIA).¹⁰⁰

1. Evolution of required disclosure of taxpayer information

Prior to the Tax Reform Act of 1976, there were two competing provisions regarding disclosure of IRS information, section 6103 and the FOIA. Section 6103 provides that tax returns and return information are confidential and, unless otherwise authorized, may not be disclosed.¹⁰¹ Conversely, the FOIA requires each federal agency to make "interpretations . . . adopted by the agency available for public review and duplication,

99. See Rev. Proc. 2002-1 § 15.10, 2002-1 I.R.B. 1. User fees *will not* be refunded to the taxpayer in the following instances: (1) if the taxpayer withdraws the request for a PLR or determination letter after it is received by the IRS (unless the cause is attributed to the IRS's charging of a higher fee than the one sent with the original request that the taxpayer is unwilling to pay), (2) if the taxpayer's request is procedurally deficient and not timely corrected, or (3) if the case is closed because the taxpayer failed to file additional information after receiving notice from the IRS to do so. See *id.* § 15.10(1)(a)-(i).

100. See 5 U.S.C. § 552 (2001). FOIA is the primary authority for availability and access to information related to the federal government. See ROBERT F. BOUCHARD & JUSTIN D. FRANKLIN, GUIDEBOOK TO THE FREEDOM OF INFORMATION AND PRIVACY ACTS 8 (1980). It provides that "'any person' has a right, enforceable in court, to access to all agency records—except to the extent the records or parts of them may be covered by one of FOIA's nine exemptions. FOIA thus applies to almost the entire range of federal activities and has resulted in a much more open government." *Id.* See *infra* note 102 (listing nine exceptions that prevent disclosure).

101. See I.R.C. § 6103(a) (2001). "Return" is defined as "any tax or information return, declaration of estimated tax, or claim for refund . . . filed with the Secretary . . . and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed." *Id.* § 6103(b)(1). "Return information" is defined as "a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, over-assessments, or tax payments," or other data collected by the IRS regarding a taxpayer's return or tax liability. *Id.* § 6103(b)(2)(A). Return information also includes "any part of any written determination or any background file document . . . not open to public inspection under section 6110," any advance pricing agreement and related background information, and any closing agreement and related background information. *Id.* § 6103(b)(2)(B)-(D).

(subject to nine enumerated exceptions)."¹⁰² In this discord, the IRS concluded that PLRs and related information were prohibited from disclosure under section 6103 because they contain private information,¹⁰³ do not have "precedential significance," and are "issued to a taxpayer on a particular transaction or set of facts and applied only to that set of facts."¹⁰⁴

Non-disclosures of this type led to claims of unfairness. Complaints included remarks "that the private letter ruling system developed into a body of law known only to a few members of the tax profession,"¹⁰⁵ such as Washington law or accounting firms with libraries containing the PLRs of its clients. This, it was argued, created an unfair advantage because, given their special access to the information contained in the rulings, the firm representatives could advise other clients of the IRS's position.¹⁰⁶ A second criticism that arose was that the tax laws were not applied equally.¹⁰⁷

The final blow to the IRS's non-disclosure of PLRs and related information came with alleged FOIA violations in *Tax Analysts & Advocates v. IRS*¹⁰⁸ and in *Fruehauf v. IRS*.¹⁰⁹ Both courts held that PLRs were subject to disclosure under the FOIA but neither addressed what parts of the rulings should be disclosed, their precedential value, or procedures for taxpayers to

102. STAFF OF THE J. COMM. ON TAX, GEN. EXPLAN. OF THE TAX REFORM ACT OF 1976 (H.R. 10612, 94th Cong., 2d session, Pub. L. 94-455) Dec. 29, 1976, reprinted in 1976-3 C.B. 1,314. [hereinafter GEN. EXPLAN. OF THE TAX REFORM ACT OF 1976]. The nine exceptions preventing disclosure under the FOIA pertain to the following: (1) information interfering with national security, (2) matters internal to an agency not of substantial and legitimate public interest, (3) material protected under another statute, (4) trade secrets and other confidential business information, (5) communication within the executive branch that is "deliberative" (i.e.: advice and recommendations but not factual information) or protected by the attorney-client or work-product privileges, (6) information about individuals the disclosure of which would be an unwarranted invasion of privacy, (7) records compiled as part of a law enforcement investigation (violation-oriented or background security investigation; not general agency audits, reviews or investigations in the manner the agency accomplishes its mission) to the extent that one of six specified harms is present, (8) and (9) records related to examinations of financial institutions and oil well information. See BOUCHARD & FRANKLIN, *supra* note 100, at 12-19.

103. See GEN. EXPLAN. OF THE TAX REFORM ACT OF 1976, *supra* note 102, at 315; see also SALTZMAN, *supra* note 15, ¶ 3.03[3][c].

104. Jonathan Sobeloff, *The New Freedom of Information Act—What it Means to Tax Practitioners*, J. OF TAX'N, (Sept. 1967), reprinted in FREEDOM OF INFORMATION ACT TEN MONTH REVIEW (submitted by the Subcomm. on Admin. Prac. and Proc. to the Comm. on the Judic. of the U.S. Sen.), May 1968, at 249 (quoting Treas. Reg. § 601.702(b)(1) (1967)).

105. GEN. EXPLAN. OF THE TAX REFORM ACT OF 1976, *supra* note 102, at 315.

106. See *id.*

107. See *id.*

108. 505 F.2d 350 (D.C. Cir. 1974).

109. 522 F.2d 284 (6th Cir. 1975), *vacated and remanded*, "for reconsideration in light of the Tax Reform Act of 1976," 429 U.S. 1085 (1977).

assert claims of privacy.¹¹⁰ In an attempt at clarification, the IRS issued procedural rules allowing for public inspection of the full text of PLRs, including identifying information.¹¹¹ There was substantial public comment on these rules and scrutiny by the Justice Department that the procedural rules might contradict other provisions of the law.¹¹² Members of Congress were responsive to resolving these issues and enacted section 6110 in the Tax Reform Act of 1976.¹¹³

2. *PLR disclosure governed exclusively by section 6110*

Section 6110 was enacted as the exclusive remedy for disclosure of rulings and related material, precluding claims for disclosure under the FOIA.¹¹⁴ The general rule of section 6110 provides that IRS written determinations—such as PLRs—along with relevant background file documents shall be open for public inspection as the Secretary allows.¹¹⁵ “Written determinations” exclude APAs.¹¹⁶ The disclosure requirements of

110. See GEN. EXPLAN. OF THE TAX REFORM ACT OF 1976, *supra* note 102, at 314-15 (citing *Tax Analysts & Advocates v. IRS*, 505 F.2d 350 (D.C. Cir. 1974) and *Fruehauf Corp. v. IRS*, 522 F.2d 284 (6th Cir. 1975)); see also SALTZMAN, *supra* note 15, ¶ 3.03[3][c], at 3-30.

111. See GEN. EXPLAN. OF THE TAX REFORM ACT OF 1976, *supra* note 102, at 315.

112. See *id.*

113. See BOUCHARD & FRANKLIN, *supra* note 100, at 9; SALTZMAN, *supra* note 15, ¶ 3.03[3][c], at 3-30. The quick Congressional response was partially motivated by the era of heightened suspicion about government secrecy: the challenges to and debates over the disclosure of letter rulings occurred shortly after former President Richard M. Nixon resigned from office in 1974 to avoid impeachment as a result of his involvement in Watergate. See, e.g., Washington Post, *Revisiting Watergate*, available at <http://www.washingtonpost.com/wp-srv/national/longterm/watergate/front.html> (last visited Feb. 18, 2002) (discussing Watergate).

114. Section 6110(m) states:

Except as otherwise provided in this title, or with respect to a discovery order made in connection with a judicial proceeding, the Secretary shall not be required by any Court to make any written determination or background file document open or available to public inspection, or to refrain from disclosure of any such documents.

I.R.C. § 6110(m) (2001). See also *Grenier v. Comm'r*, 449 F. Supp. 834, 839 (D.C. Md. 1978) (“Congress evinced intent to displace Freedom of Information Act as means of access to unpublished Internal Revenue Service rulings.”) (internal citations omitted); see SALTZMAN, *supra* note 15, ¶ 3.03[3][c], at 3-30 (limiting disclosure to section 6110).

115. See I.R.C. § 6110(a) (2001); see generally Treas. Reg. §§ 301.6110-1(a) through 301.6110-7 (1963). The Secretary may dispose of any *general written determination* or *background file document* three years after it is made available for public inspection but not of any *reference written determinations* and related background file documents. See *id.* § 6011(k)(2). See *infra* note 116 for definitions of italicized terms. The text of any PLRs open for public inspection under section 6110 is located in the reading room at the IRS National Office. See Treas. Reg. § 301.6110-1(c)(1)-(3) (2001). Materials may not be removed from the reading rooms (although they may be photocopied). See *id.*

116. See I.R.C. § 6110(b)(1), (3) (2001); Treas. Reg. § 301.6110-2(a) (2001). They can be classified as either reference or general written determinations. “A reference written determination is a written determination that the Secretary deems to have significant reference

section 6110 do not apply to confidential information arising under a treaty obligation or related to applications of organizations for tax-exempt status.¹¹⁷

Per subsection c of section 6110, before making information available for public review, the Secretary must redact identifying information,¹¹⁸ classified information,¹¹⁹ specifically exempted information,¹²⁰ certain business information,¹²¹ private information,¹²² financial institution regulation information,¹²³ and geological and geophysical information and data.¹²⁴ The Secretary shall determine the extent of the deletions and is not liable for failing to make them unless the omission is intentional or willful, or the deletions were either affirmatively agreed to or court ordered.¹²⁵

Upon issuing a written determination or background file document, the Secretary must mail a notice of intention to disclose to any person about

value." I.R.C. § 6110(b)(2)(C). A "general written determination" is any written determination other than a reference written determination. *Id.* § 6110(b)(3)(B). A "background file document" includes the request for the determination, material submitted in support of the request, and communication, written or otherwise between the IRS and those outside of the IRS in connection with the determination. *Id.* § 6110(b)(2). When a written determination is open for public inspection, upon written request, the Secretary also makes any background file document relating to the written determination available to the requestor. *Id.* § 6110(e).

117. *See generally* I.R.C. § 6110(d)(1) (2001) (excluding information in sections 6104 and 6105 from disclosure); I.R.C. § 6104 (2001) (providing separate rules for publicity of organizations' applications for tax-exempt status under sections 501(a) or 527); I.R.C. § 6105 (2001) ("Tax convention [generally defined as any agreement entered into with the competent authority of a foreign government pursuant to a tax convention] information shall not be disclosed.").

118. *See* Treas. Reg. § 301.6110-3 (2001). Examples of identifying information that is deleted are the names and addresses of the person to whom the determination pertains. *See id.* Information is considered to identify a person if a reasonable person who is generally knowledgeable about a community could identify the person based on the information available when the ruling is disclosed as well as the information that will be made available reasonably thereafter. *See* SALTZMAN, *supra* note 15, ¶ 3.03[3][c], at 3-32 (citing Treas. Reg. § 301.6110-3(a)(1) (2001)); GEN. EXPLAN. OF THE TAX REFORM ACT OF 1976, *supra* note 102, at 1,315.

119. *See* Treas. Reg. § 301.6110-3(a)(2) (2001). Classified information that is deleted is specifically authorized (such as in an executive order) to be confidential in the interest of national defense or foreign policy. *See id.*

120. *See* Treas. Reg. § 301.6110-3(a)(3) (2001). Specifically exempted information pertains to information specifically exempted from disclosure by a statute applicable to the IRS. *See id.*

121. *See* Treas. Reg. § 301.6110-3(a)(4) (2001). Examples of redacted business information include: trade secrets and privileged or confidential commercial or financial information. *See id.*

122. *See* Treas. Reg. § 301.6110-3(a)(5) (2001). Private information is information that, if disclosed, a "clearly unwarranted invasion of personal privacy would result." *Id.*

123. *See* Treas. Reg. § 301.6110-3(a)(6) (2001). Financial institution regulation information includes information related to examining, operating, or reporting to agencies regulating and supervising financial institutions. *See id.*

124. *See* Treas. Reg. § 301.6110-3(a)(7) (2001). An example of geological and geophysical information and data is maps concerning wells. *See id.*

125. *See* I.R.C. § 6110(c) (2001).

whom the written determination pertains.¹²⁶ The written determination or background file document becomes available for public inspection at the later of between seventy-five and ninety days after the notice of intention to disclose is mailed or within thirty days after a court decision becomes final.¹²⁷ To challenge the information not redacted by the IRS, the person requesting the PLR must have exhausted available administrative remedies, including the submission of a proposed deletion statement to the IRS, followed by a letter to the IRS stating further information and arguments to support omitting the material within ten days of receiving the proposed letter ruling.¹²⁸ Finally, a written statement must be submitted within twenty days of receiving the IRS' intention to disclose in which the deletions not made by the IRS are identified on a copy of the PLR with the proposed deletions enclosed in brackets.¹²⁹

III. ADVANCE PRICING AGREEMENTS

An APA is a binding agreement between the IRS and a taxpayer about the transfer pricing methodology (TPM) to be applied to the apportionment or allocation of income, deductions, credits, or allowances between or among two or more related taxpayers.¹³⁰ The agreement is made in advance of the

126. See I.R.C. § 6110(f)(1) (2001).

127. See *id.*; Treas. Reg. § 301.6110-5(b)(5) (2001).

128. See Treas. Reg. §§ 301.6110-5(b)(1); 601.201(e)(11). The IRS will attempt to resolve these issues prior to providing the PLR but the person requesting the PLR is not entitled to a conference to resolve the disagreement over the material to be deleted. See Treas. Reg. § 601.201(e)(11) (2001).

129. See Treas. Reg. § 601.201(e)(16) (2001). The IRS shall mail its final administrative conclusion regarding the deletions to be made within twenty days after receiving the response by the person requesting the ruling. See *id.* After exhausting these administrative remedies, if the person to whom the written determination pertains continues to object to the disclosure, he or she may file a petition and statement of proposed deletions in the United States Tax Court within sixty days of the Secretary's notice of intention to disclose. See I.R.C. § 6110(f)(3) (2001); Treas. Reg. § 301.6110-5(b)(2)-(3) (2001). Similarly, an action to obtain additional disclosure may be pursued once administrative remedies have been exhausted by filing a petition with the United States Tax Court or a complaint in the United States District Court for the District of Columbia requesting an order that any written determination or background file document be made available for public inspection. See I.R.C. § 6110(f)(4). The burden of proof regarding disclosure is on persons seeking to restrain disclosure. See *id.* Resolving the issue by the earliest practicable date, the Tax Court may disclose portions of related hearings, testimony, evidence, and reports to the public. See I.R.C. § 6110(f)(2) (2001). This time period may be extended for as long as the court determines is necessary for the Secretary to comply with its decision or, at the written request of the person requesting the written determination, for the lesser of ninety days or until fifteen days after the Secretary's determination that the underlying transaction has been completed (unless good cause is demonstrated for further delay of disclosure). See I.R.C. § 6110(f)(2), (3). Remedies for section 6110 claims must be brought in the Court of Claims. See Treas. Reg. § 301.6110-7(c) (2001).

130. See Charles S. Triplett & C. Cabell Chinnis, Jr., *United States [Advance Rulings]* printed in INT'L BUREAU OF FISCAL DOC., INT'L GUIDE TO ADVANCE RULINGS, ¶ 6.1 (1999).

underlying transaction. The United States was the first country to create an APA program of this kind. The APA program officially began in 1991 and has served as a model for other countries to resolve transfer pricing disputes.¹³¹ The following discussion provides a context for the APA program, and addresses the program as it relates to concepts associated with advance rulings.

*A. IRS Authority to Challenge Amounts Not Clearly Reflecting Arm's Length Prices*¹³²

Section 482 provides that the Secretary of the Treasury may “distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among” two or more related organizations, trades, or businesses—regardless of where organized—“to prevent evasion of taxes or clearly to reflect the income of ... such organizations, trades, or businesses.”¹³³ The objective of this provision “is to place ‘a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income of the controlled taxpayer.”¹³⁴

True taxable income is usually determined by the arm's length cost, also referred to as the fair market value, of a comparable transaction.¹³⁵ Depending

131. *See id.* *See also* Rev. Proc. 91-22, 1991-1 C.B. 526 (announcing the APA program).

132. The process described herein oversimplifies the process of determining an arm's length price given the complexities of today's market. As a more detailed analysis of these issues are beyond the scope of this paper, consult the sources cited within this section for further information.

133. I.R.C. § 482 (2001). In its entirety, section 482 provides:

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

Id.

134. BORIS I. BITTKER & LAWRENCE LOKKEN, FUNDAMENTALS OF INTERNATIONAL TAXATION, ¶ 79.1.1 (student 2d ed. 2001) (quoting Treas. Reg. § 1.482-1(b)(1), quoted with approval in *Commissioner v. First Sec. Bank of Utah*, 405 U.S. 399, 400 (1972)).

135. *See id.*; CHARLES H. GUSTAFSON ET AL., TAXATION OF INTERNATIONAL TRANSACTIONS ¶ 8045, at 634 (2d ed. 2001) (quoting Treas. Reg. § 1.482-1(b)(1) (2001)). The effectiveness of the arm's length cost as a true measure of taxable income has been criticized because of “the absence of comparable arm's length transactions between unrelated parties, and the inconsistent results of attempting to impose an arm's length concept in the absence of comparables.” BITTKER & LOKKEN, *supra* note 134, ¶ 79.1.1 (quoting Staff of Joint Comm. on Tax'n, 99th Cong., 2d Sess., Gen. Explan. of the Tax Reform Act of 1986, at 1014 (Comm. Print 1987)).

on the comparisons and methods used, different results may be obtained; the application of a best method may yield "a number of results from which a range of reliable results may be derived."¹³⁶ This continuum is referred to as the "arm's length range."¹³⁷ If the results fall within this range, then the taxpayer's proposed prices will not be adjusted.¹³⁸

B. Consequences of Transfer Pricing Between Foreign and Domestic Related Parties

The IRS invokes section 482 most frequently to challenge transfer prices and expense allocations between domestic corporations and foreign affiliates that are not subject to United States tax on foreign income.¹³⁹ For example, the IRS may invoke its authority under section 482 to challenge the sale of goods at cost by a United States corporation to its foreign subsidiaries because the profits earned when the goods are resold overseas would not be taxed by the United States until they are repatriated (*e.g.*, through a dividend distribution by the foreign subsidiary to its United States parent.)¹⁴⁰

Adjustments to an item of income under section 482 for one taxpayer in a control group results in a collateral adjustment to other members in the control group, such as "correlative allocations, deductions, conforming adjustments and setoffs."¹⁴¹ This may be illustrated in the example above; the price at which the parent's products are transferred to the subsidiary must

136. GUSTAFSON, *supra* note 135, ¶ 8045, at 636 (quoting Treas. Reg. § 1.482-1(e) (2001)). The following factors must be considered when determining the comparability of transactions: the resources used, the contractual terms, the risks, the weight of the economic conditions, and the nature of the property or services. *See id.* ¶ 8045 (citing Treas. Reg. § 1.482-1(d) (2001)). Differences attributed to attempts to enter or expand a market, comparisons of different markets, and different geographic locations may alter this analysis. *See id.* (citing Treas. Reg. § 1.482-1(d)(4) (2001)).

137. *Id.*

138. *See id.*

139. *See* BITTKER & LOKKEN, *supra* note 134, ¶ 79.1.1. The IRS has an incentive to invoke section 482 to increase tax collections in international transactions when the controlled arrangement is between a supplier and producer (as in the example set forth in the text accompanying note 140). *See* GUSTAFSON, *supra* note 135, ¶ 8020. By doing so, the IRS implicates the foreign tax credit limitations so foreign and United States-source income and deductions may be accurately measured. *See id.* The IRS also implicates attempts to shift income to tax haven subsidiaries to avoid constructive dividend treatment under controlled foreign corporation rules. *See id.*

140. *See* BITTKER & LOKKEN, *supra* note 134, ¶ 79.1.1. Transactions of this type are challenged because the United States parent receives the benefit of deferring the income tax owed to the United States and, if the U.S. parent can deduct the cost of conducting foreign operations from its domestic income, then the U.S. parent also receives an additional benefit of reduced taxable income and resulting U.S. tax. *See id.*

141. GUSTAFSON, *supra* note 135, ¶ 8005, at 628 (citing Treas. Reg. § 1.482-1(g) (2001)).

contemplate a reasonable profit and deductions attributable to the subsidiary for the expense of conducting the foreign operations.¹⁴²

Problems regarding jurisdiction and double taxation of the same income arise when section 482 adjustments are made between or among control groups of foreign and domestic taxpayers. The United States does not have jurisdiction to alter the income of the foreign taxpayer if the foreign taxpayer does not pay United States taxes.¹⁴³ This is significant because the purpose of section 482 is to allocate income and deductions to the proper taxpayers.¹⁴⁴ For example, when the IRS makes adjustments under section 482 between two United States controlled entities, A and B, it will decrease income attributed to entity A to offset the increase in income attributed to entity B.¹⁴⁵ As a result, entity A's United States income tax liability is decreased; entity B's United States income tax liability is increased. If an entity involved in the section 482 adjustment is a foreign taxpayer and the income—and therefore income tax liability—attributed to the United States taxpayer is increased, there is no corresponding reduction in taxable income for the foreign controlled group member. This may result in multiple taxations of the same income because foreign tax officials are usually similarly authorized to adjust and allocate income and deductions between or among taxpayers.¹⁴⁶

If a United States tax treaty is in effect between the United States and a foreign country, United States' taxpayers may seek relief through the "competent authority provision," which permits taxpayers to request assistance from the United States competent authority when either treaty partner is imposing taxes inconsistent with the treaty.¹⁴⁷ If a taxpayer's request for competent authority assistance is accepted, then the United States competent authority will generally consult with the appropriate foreign

142. See, e.g., BITTKER & LOKKEN, *supra* note 134, ¶ 79.1.1.

143. See GUSTAFSON, *supra* note 135, ¶ 8040, at 633. If the foreign entity's income is or becomes relevant for United States tax purposes, then it will be altered to reflect the section 482 adjustment. See *id.*

144. See *id.*

145. See *id.*

146. See generally *id.* To illustrate: taxpayer A from country one and taxpayer B from country two, both in the same control group, engage in a transaction. The taxing agencies of both country one and country two are authorized to adjust income and deductions of its taxpayers. Country one may allocate income from a transaction to its domestic taxpayer, A. Because it lacks jurisdiction to do so, no related decrease in income is attributed to taxpayer B, as taxpayer B does not pay tax in country one. After analyzing the transaction, country two may conclude that allocating the income in question to taxpayer B more accurately reflects income. As in country one, country two may lack jurisdiction to make a corollary reduction in income to taxpayer A. A double tax results because the same portion of income is taxed in each country. See *id.* at 634.

147. See *id.* The Assistant Commissioner (International) is the United States competent authority for interpreting tax treaties (acting with the concurrence of the Associate Chief Counsel (International)). See Rev. Proc. 96-13 § 2.01, 1996-1 C.B. 616.

competent authority and attempt to reach a mutual agreement satisfactory to all parties.¹⁴⁸

C. APA Defined

An APA is a binding agreement issued by the Office of Associate Chief Counsel (International) between the IRS and a taxpayer determining the prospective, applicable TPM "to any apportionment or allocation of income, deductions, credits, or allowances between or among two or more organizations, trades, or businesses owned or controlled, directly or indirectly by the same interests."¹⁴⁹ The TPM represents the best method provided under the regulations governing section 482 as agreed to by the taxpayer and the IRS.¹⁵⁰ Although advance ruling requests generally resolve legal rather than factual questions, the IRS created the APA process to provide a "flexible problem-solving process based on cooperative and principled negotiations between taxpayers and the Service."¹⁵¹

D. Procedure for Obtaining an APA

A taxpayer initiates the procedure for obtaining an APA by submitting a request¹⁵² containing copies of all relevant documents related to the proposed TPM¹⁵³ and a user fee, ordinarily \$25,000.¹⁵⁴ The taxpayer also

148. See Rev. Proc. 96-13 § 2.03, 1996-1 C.B. 616. See *infra* note 163 and accompanying text for discussion of coordination of APA procedure and competent authority agreement.

149. Rev. Proc. 96-53 § 1, 1996-2 C.B. 375. See also *id.* § 10.01 (an APA is a binding agreement). If the taxpayer complies with the conditions of the APA, the IRS will regard the underlying transaction as satisfying the arm's length standard according to the terms of the APA. See *id.* § 10.02.

150. See Rev. Proc. 96-53 § 1, 1996-2 C.B. 375.

151. Rev. Proc. 96-53 § 3.01, 1996-2 C.B. 375. See also GUSTAFSON, *supra* note 135, ¶ 8175.

152. See Rev. Proc. 96-53 § 3.09, 1996-1 C.B. 375. Prior to submitting an APA request, the taxpayer may request a conference with the IRS to determine whether the underlying transaction is suitable for an APA and, if so, to clarify the particular information that should be included with the request. See *id.* An English translation must accompany all documents submitted in a foreign language. See *id.* § 5.01(3). Once completed, the taxpayer should sign the request and submit the original and seven copies to the IRS. See *id.* § 5.12-13.

153. See Rev. Proc. 96-53 § 5.01(2), 1996-1 C.B. 375. The IRS retains all materials submitted in its files, therefore original documents should not be submitted. See *id.* § 5.01(1). The taxpayer may be required to provide an independent expert at its own expense to review and provide an opinion about the taxpayer's proposed TPM. See Rev. Proc. 96-53 § 9, 1996-1 C.B. 375.

154. See Rev. Proc. 96-53 §§ 5.01(4), 14(1) 1996-1 C.B. 375. The following summarizes the exceptions to the \$25,000 user fee requirement. See *id.* § 5.14.

<u>Standard to Determine APA User Fee</u>	<u>APA User Fee</u>
Taxpayer's gross income more than \$100,000 but not less than \$1,000,000	\$15,000
Taxpayer's gross income less than \$100,000	\$5,000

encloses general factual and legal information;¹⁵⁵ a detailed explanation of each proposed TPM (which applies the TPM to the financial and tax data of the previous three taxable years of the parties);¹⁵⁶ specific factual items related to the proposed transaction;¹⁵⁷ an annual report;¹⁵⁸ a signed perjury

Total annual value of transaction not more than \$50,000,000 (Property/Services)*	\$7,500
Total annual value of transaction not more than \$10,000,000 (Intangibles)*	\$7,500
Requests involving more than one jurisdiction:	
Initial request	\$25,000
Additional jurisdictions	Schedule/\$7,500**
Renewal of an APA substantially unchanged from the initial APA	\$7,500

*The annual value fee provisions apply regardless of the taxpayer's gross income.

**The usual fee schedule shall be applied unless the request involves the same issues and the same product line, goods, services or intangibles as in the first APA.

155. See Rev. Proc. 96-53 § 5.03, 1996-1 C.B. 375. Each APA request must include: (1) a list of the organizations, trades, businesses, and transactions that will be subject to the APA; (2) a list of names, addresses, telephone numbers, and taxpayer identification numbers of the controlled taxpayers that are parties to the requested APA; (3) a power of attorney form for any and all authorized representatives of the taxpayers; (4) a brief description of the general history of business operations, worldwide organizational structure, ownership, capitalization, financial arrangements, principal businesses, and the place or places where such businesses are conducted, and major transaction flows of the parties; (5) representative financial and tax data of the parties for the last three taxable years, along with other relevant data and documents in support of the proposed TPM (such as income tax returns, financial statements, and annual reports); (6) a statement of the currency used by each party and the currency in which payment between parties is made for the transactions that will be covered by the APA; (7) a statement of the taxable year of each party; (8) a description of significant financial accounting methods used by the parties directly related to the proposed TPM; (9) an explanation of significant financial and tax accounting differences, if any, between the United States and the foreign countries involved that have a bearing on the proposed TPM; (10) a discussion of the relevant statutory provisions, tax treaties, court decisions, regulations, revenue rulings, or revenue procedures; (11) a statement describing all previous and current issues at the examination, appeals, judicial, or competent authority levels, along with a description of both the taxpayer's and the government's positions. See *id.*

156. See Rev. Proc. 96-53 § 2, 5.02 1996-2 C.B. 375. The taxpayer must, to the extent possible, submit relevant pricing data from closely comparable uncontrolled transactions. See *id.* § 3.03. If the taxpayer is unable to obtain such information, then the taxpayer must identify transactions believed comparable but for which reliable data is not available. See *id.* If comparable transactions cannot be identified then the taxpayer must submit information from transactions that are similar, uncontrolled transactions with proposed adjustments to account for the differences between the transactions. See *id.* If no comparable, uncontrolled transaction can be identified, the taxpayer may demonstrate that, despite this lack of comparability, the proposed TPM satisfies section 482. See *id.* If the information about the previous three taxable years is not available then the taxpayer may use hypothetical data. See *id.* § 5.02.

157. See Rev. Proc. 96-53 § 5.04, 1996-1 C.B. 375. The following specific factual information may be included in an APA request to establish the arm's length basis for the proposed TPM: (1) measurements of profitability and return on investment; (2) a functional analysis of the economic activities performed, the assets employed, the economic costs incurred, and the risks assumed by each party; (3) an economic analysis of the general industry pricing practices and economic functions within the markets and geographical areas to be covered by the APA; (4) a list of the taxpayer's competitors and a discussion of any uncontrolled

statement;¹⁵⁹ and a discussion of any income tax issues collateral to the request.¹⁶⁰ The taxpayer must propose any fact, referred to as a "critical assumption," whose continued existence is material to the TPM, such as a range of expected business volume¹⁶¹ and an initial term spanning no more than three years for the APA.¹⁶² The taxpayer must also include information about whether the underlying transaction involves a treaty country as well as whether the taxpayer is requesting competent authority consideration.¹⁶³

There is no time limit by which an APA request must be processed; the average time for processing a request varies based on the type and complexity of the APA.¹⁶⁴ The average time to complete unilateral APA requests is seventeen months while bilateral APA requests average thirty-two months.¹⁶⁵ To keep the APA process flexible to respond to the specific needs of particular taxpayers, the IRS and the taxpayer may agree to special procedures to reach an APA agreement, particularly when the taxpayer is a small business

transactions, lines of business or types of businesses comparable or similar to those in the request; (5) a detailed explanation of the efforts and criteria used to identify and select possible independent comparables, and of the application of the criteria to the potential comparables, including a list of potential comparables and an explanation of why each was either accepted or rejected; (6) a detailed explanation of the selection and application of the factors used to adjust the activities of selected independent comparables for purposes of devising the proposed TPM. *See id.*

158. *See* Rev. Proc. 96-53 § 5.08, 1996-2 C.B. 375.

159. *See* Rev. Proc. 96-53 § 5.11, 1996-2 C.B. 375. *See supra* note 28 and accompanying text for discussion of similar perjury statement provisions.

160. *See* Rev. Proc. 96-53 § 5.06, 1996-2 C.B. 375.

161. *See* Rev. Proc. 96-53 § 5.07, 1996-2 C.B. 375.

162. *See* Rev. Proc. 96-53 § 5.09, 1996-2 C.B. 375. The term should be appropriate to the industry, product, or transaction involved. *See id.* § 5.09(1). APA requests may not be filed beyond the time for filing the taxpayer's federal income tax return for the first year the APA is proposed to cover. *See id.* § 5.09(2). If facts, law, and available records support the conclusion that a TPM obtained through an APA may apply to years prior than those covered by the APA, the IRS will "rollback" the TPM, making it apply to those earlier years. *See* Rev. Proc. 96-53 § 3.06, 1996-1 C.B. 375. The purpose for providing rollback treatment is to enhance a taxpayer's voluntary compliance with the tax code and to use resources addressing unresolved transfer pricing issues effectively. *See id.* *See also* Rev. Proc. 96-53 § 8, 1996-1 C.B. 375.

163. *See* Rev. Proc. 96-53 §§ 2, 5.10, 1996-1 C.B. 375. Taxpayers are encouraged to request a competent authority agreement regarding matters subject to the APA to avoid double taxation for all applicable periods. *See* Rev. Proc. 96-13 § 7.04, 1996-1 C.B. 616. Competent authority consideration should be requested under Rev. Proc. 96-53. Rev. Proc. 2001-1 § 3.04, 2001-1 I.R.B. 1. If APA negotiations are bilateral or multilateral, involving one or more foreign competent authorities, then the initial negotiating position of the United States competent authority is the IRS's opinion of the appropriate TPM, based on consultations with the taxpayer. *See* Rev. Proc. 96-53 § 3.01, 1996-1 C.B. 375.

164. *See* ADVANCE RULINGS, *supra* note 2, ¶ 2.2.5, at 635.

165. *See id.* (citing *IRS Finishes Record Number of APAs in FY98, Also Sees Surge in New Filings*, 7 TAX MGMT., TRANSFER PRICING REPORT 12 (1998)).

or to facilitate negotiations among the IRS, the taxpayer, and a foreign competent authority.¹⁶⁶

E. Processing of APA Request by IRS

After evaluating the data submitted, the IRS discusses the APA request with the taxpayer.¹⁶⁷ Within forty-five days of receiving the request, the APA director assigns the review of the request to an appointed APA team consisting of at least one representative of the Office of Associate Chief Counsel (International), representatives of the appropriate District and District Counsel and, when appropriate, Appeals and the United States Competent Authority.¹⁶⁸ The APA team meets with the taxpayer to develop a case plan and schedule. The APA team and the taxpayer list each question raised during the initial IRS review of the request and determine a schedule by which the issue will be resolved.¹⁶⁹ The APA team is responsible for administering the APA request, which includes negotiating, documenting, and recommending an agreement to the Associate Chief Counsel (International).¹⁷⁰ The APA is binding once both the Associate Chief Counsel (International) and the taxpayer sign the proposed APA.¹⁷¹

166. *See* Rev. Proc. 96-53 § 3.09, 1996-1 C.B. 375. Using a simplified process is an example of "special procedure." *See id.*

167. *See* Rev. Proc. 96-53 §§ 2, 6.01-03 1996-2 C.B. 375.

168. *See* Rev. Proc. 96-53 § 6.04, 1996-1 C.B. 375. The APA Director also appoints a team leader to oversee the APA team's activities. *See id.*

169. *See* Rev. Proc. 96-53 § 6.05(1), (2), 1996-1 C.B. 375. The case plan and schedule reflects an agreement between the APA Team and the taxpayer on the scope of any additional information required to negotiate an APA. *See id.* Specific dates should be agreed upon for case milestones, including: (a) the taxpayer's submission of necessary, additional information; (b) the government's evaluation of information; (c) negotiation of a recommended agreement or competent authority negotiating position; and (d) presentation of the recommended agreement or competent authority negotiating position in writing to the Associate Chief Counsel (International). *See id.* § 6.05(1). The time for completing these milestones depends on the scope and complexity of the particular case. *See id.* § 6.05(2). If the request is bilateral or multilateral, the IRS will attempt to minimize the time for competent authority resolution by working with the competent authority of the treaty partner as best as possible. *See id.*

170. *See* Rev. Proc. 96-53 § 6.05(1), 1996-1 C.B. 375. If applicable, the APA team's recommendation should be in consultation with a competent authority negotiating position. *See id.* The District Director responsible for the taxpayer's returns is afforded the opportunity to review and comment on the draft APA (unilateral APAs) or proposed initial United States competent authority negotiating position (bilateral or multilateral APAs). *See id.* § 6.05(6).

171. *See* Rev. Proc. 96-53 §§ 2, 6.05(5), 1996-1 C.B. 375. A taxpayer may withdraw an APA before it is executed (signed), although the user fee will generally not be returned. *See id.* § 6.06. Similarly, the IRS may decline to accept an APA request or decline to execute an APA after a request has been accepted. *See id.* § 6.07. If the IRS does not execute an APA after the request has been initiated, it normally will not return the user fee unless otherwise appropriate under the circumstances. *See id.* If the Service proposes to reject an APA request, the taxpayer will be granted one conference of right. *See id.*

F. Consideration by Competent Authority

When a tax treaty between the United States and a foreign country applies to a transaction for which an APA request has been made, any party is entitled to relief under the treaty's competent authority provision.¹⁷² The United States and foreign competent authorities are responsible for negotiating issues that interfere with a purpose of the treaty and one of which is avoiding double taxation.¹⁷³ A final agreement to the negotiated APA will be sought among the taxpayer, the IRS, and the foreign competent authority, but if the competent authorities are unable to reach an agreement or the taxpayer does not accept the competent authority agreement, the IRS will attempt to negotiate a unilateral APA with the taxpayer.¹⁷⁴

"Any information received or prepared by the [IRS], including information furnished by the taxpayer or the related foreign entity, [will be] subject to the restrictions on disclosure of tax related information provided by [U.S.] law and the applicable income tax convention."¹⁷⁵ If the IRS must analyze confidential data that could harm the taxpayer if disclosed (such as trade secrets) "the parties will attempt to negotiate a mechanism to permit verification [of the information] by a foreign competent authority without disclosing such information."¹⁷⁶ When the competent authorities enter into an APA agreement, the IRS will—to the extent practicable—agree to mutually exchange information with the foreign competent authority concerning "subsequent modifications, cancellation, revocation, requests to renew, evaluation of annual reports, or examination of the taxpayer's compliance with the terms and conditions of the APA."¹⁷⁷

G. Limited Use of Taxpayer Information Associated with an APA Request

Neither the IRS nor the taxpayer may introduce the APA, nor any non-factual oral or written representations made in connection with the APA, as evidence in a judicial or administrative proceeding concerning an issue beyond the scope of the APA.¹⁷⁸ This rule also applies if an APA is not

172. See Rev. Proc. 96-53 § 7.01-02, 1996-1 C.B. 375.

173. See *id.* The negotiations are primarily between the United States and foreign competent authorities although the taxpayer should be available while the request is considered. See *id.*

174. See Rev. Proc. 96-53 § 7.02, 1996-1 C.B. 375.

175. Rev. Proc. 96-53 § 7.03, 1996-1 C.B. 375.

176. Rev. Proc. 96-53 § 7.04, 1996-1 C.B. 375.

177. Rev. Proc. 96-53 § 7.05, 1996-1 C.B. 375. The United States competent authority will attempt to persuade the foreign competent authority to use APA data only on terms similar to those described *infra* at notes 178-179 and accompanying text. See *id.* § 7.06.

178. See Rev. Proc. 96-53 § 10.04, 1996-1 C.B. 375. Note that this restriction does not prevent rollback of the APA TPM, nor the discovery, use, or admissibility of non-factual material otherwise discoverable or obtained other than in the APA process because the same

executed or one is executed but later revoked or canceled. The rule extends to prevent using such information as an admission by the other party in any administrative or judicial proceeding for the taxable years for which the APA was requested or executed.¹⁷⁹

H. Administering the APA

The taxpayer must file an annual report that describes actual operations for the year and demonstrate good faith compliance with the APA for each year covered by the agreement.¹⁸⁰ This report must describe requests to renew, modify or cancel the APA; explain any compensating adjustments;¹⁸¹ and detail all items required by the APA.¹⁸²

If a taxpayer party to an APA is audited for a tax year covered by the agreement, the examination is limited to a review of the taxpayer's good faith compliance with the terms and conditions of the APA; whether the taxpayer's material representations in the APA and the annual reports are valid and accurate; whether supporting data and computations used to apply the TPM were materially accurate; whether the critical assumptions underlying the APA are valid; and whether the taxpayer has consistently applied the TPM and met the critical assumptions.¹⁸³

information was also included in the APA process. *See id.* *See supra* note 162 and accompanying text.

179. *See* Rev. Proc. 96-53 § 10.05, 1996-1 C.B. 375. Note that this restriction does not prevent discovery, use, or admissibility of non-factual material otherwise discoverable or obtained other than in the APA process because similar material was also included in the APA process. *See id.*

180. *See* Rev. Proc. 96-53 § 11.01(1), 1996-1 C.B. 375.

181. *See id.* "Compensating adjustments" are adjustments made by the taxpayer and its related foreign entity when the results of applying the TPM differ from those contemplated by the APA. Rev. Proc. 96-53 § 11.02(1), 1996-1 C.B. 375. A compensating adjustment is appropriate when an APA provides a range of expected operating results and the actual operating results are outside that range but within the limits specified in the APA. *See id.* The APA may allow the parties to make a compensating adjustment to bring the results to an agreed upon point within the described range. *See id.* *See* Rev. Proc. 96-53 § 11.02(2)-(5), 1996-1 C.B. 375 for further discussion of compensating adjustments.

182. *See* Rev. Proc. 96-53 § 11.01(1), 1996-1 C.B. 375.

183. *See* Rev. Proc. 96-53 § 11.03(1)-(2), 1996-1 C.B. 375. If the District Director finds these requirements have not been met then the issue will be submitted to the Associate Chief Counsel (International), who will continue to apply the APA or revoke, cancel, or revise it. *See id.* § 11.03(3). *See infra* notes 184-187 and accompanying text (revision); notes 188-193 and accompanying text (cancellation); notes 194-196 and accompanying text (revocation); and notes 197-198 and accompanying text (renewal).

I. Revision, Cancellation, Revocation, and Renewal of an APA

If a critical assumption has not been met or there has been a change in the law or applicable treaty,¹⁸⁴ an affected APA must either be revised by the parties or cancelled.¹⁸⁵ If the IRS and the taxpayer revise an APA that has been subject to competent authority agreement, the IRS will seek the consent of the foreign competent authority to the revised APA.¹⁸⁶ If the foreign competent authority refuses to accept the revised APA or the competent authorities cannot agree on a revised APA, the taxpayer and the IRS may agree to continue applying the existing APA, to apply the revised APA, to further revise the APA, or to cancel the APA.¹⁸⁷

The Associate Chief Counsel (International) may cancel the APA for a misrepresentation, mistake or omission of material fact, or lack of good faith compliance¹⁸⁸ with the terms and conditions of the APA.¹⁸⁹ "Material facts are those that, if known by the [IRS], would have resulted in [the issuance of a significantly] different APA or no APA at all."¹⁹⁰ If the taxpayer can satisfactorily demonstrate good faith and reasonable cause and agrees to make any proposed adjustments to correct for the misrepresentation, mistake, omission, or noncompliance, "then the Associate Chief Counsel (International) may waive cancellation."¹⁹¹ Conversely, the Associate Chief Counsel (International) is not required to cancel the APA and may require the taxpayer to continue to abide by it.¹⁹² If an APA is cancelled, then the cancellation will be effective as of the beginning of the year in which the misrepresentation, mistake, omission, or noncompliance occurred or as of the effective date of the change in law or treaty, whichever is applicable.¹⁹³

The Associate Chief Counsel may, but is not required to, revoke an APA if the taxpayer has committed fraud, malfeasance, or disregard in obtaining or

184. See Rev. Proc. 96-53 § 11.09, 1996-1 C.B. 375. "Changes in law or treaty" are those that alter the federal income tax treatment of a matter covered by the APA. See *id.* The new law or treaty provision supersedes the APA only to the extent of any inconsistencies between the two. See *id.*

185. See Rev. Proc. 96-53 § 11.07(1), 1996-1 C.B. 375. If the taxpayer and the IRS cannot execute a revised agreement, the APA will be cancelled, effective at the beginning of the taxable year in which the failure to meet a critical assumption occurred. See *id.* § 11.07(3). If the IRS and the taxpayer can agree on a revised APA, the effective date of the revised APA will be stated in the new APA. See *id.*

186. See Rev. Proc. 96-53 § 11.07(4), 1996-1 C.B. 375.

187. See *id.* If an agreement cannot be reached the APA will be cancelled. See *id.*

188. See Rev. Proc. 96-53 § 11.06(1), 1996-1 C.B. 375. "Fraud, malfeasance or disregard" does not constitute lack of good faith. See *id.* See *infra* note 194 for discussion of these standards as they apply to revocations of APA agreements.

189. See *id.*

190. *Id.*

191. Rev. Proc. 96-53 § 11.06(2), 1996-1 C.B. 375.

192. See *id.*

193. See Rev. Proc. 96-53 § 11.06(3), 1996-1 C.B. 375.

meeting subsequent reporting requirements in connection with the APA.¹⁹⁴ If the APA is revoked, the revocation may be retroactive to the first day of the first taxable year for which the APA was effective, resulting in possible assessments of income tax deficiencies for that time period.¹⁹⁵ When an APA has been the subject of negotiation with a foreign competent authority, the IRS will attempt to coordinate actions related to the revocation with the foreign competent authority.¹⁹⁶

"A taxpayer may request renewal by following the form and procedures that apply to initial APA requests," including submission of a user fee and supporting documentation.¹⁹⁷ The renewal request should be filed no later than nine months before the existing term expires.¹⁹⁸

J. Disclosure of APAs

Information associated with the APA process relates directly to the existence and amount of tax liability of the taxpayer; therefore, both the APA and related information are confidential per section 6103, as well as under applicable income tax conventions or rules related to communications with foreign governments.¹⁹⁹

IV. U.S. RULING PROGRAM PROMOTES FAIR TAX COMPETITION CONSISTENT WITH EUROPEAN COMMUNITY (EC) AND ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD) RECOMMENDATIONS

The United States discloses the procedures for obtaining PLRs and APAs, as well as the results of PLRs. The United States also applies these procedures non-discriminatorily to similarly situated taxpayers. These

194. See Rev. Proc. 96-53 § 11.05(1), 1996-1 C.B. 375. "Fraud" and "malfeasance" are interpreted under the same standards as under section 7121; "disregard" is any careless, reckless, or intentional disregard or "any failure to make a reasonable attempt to comply" with applicable provisions. See I.R.C. § 6621(b)(1), (c) (2001). Occasions implicating possible revocations of APAs include fraud, malfeasance, or disregard involving the material facts set forth in the request, or lack of good faith in complying with the terms of the APA. See *supra* text accompanying note 190 for a definition of "material facts."

195. See Rev. Proc. 96-53 § 11.05(3), 1996-1 C.B. 375. If the revocation of the APA is considered an "egregious case" under Rev. Rul. 80-231, 1980-2 C.B. 219, then the taxpayer may be denied a foreign tax credit. See *id.*

196. See *id.*

197. Rev. Proc. 96-53 § 11.08, 1996-1 C.B. 375. See *supra* section III.C.2.d for a discussion of procedures for filing initial APA requests and *supra* note 154 for listing of APA user fees.

198. See *id.*

199. See Rev. Proc. 96-53 § 12, 1996-1 C.B. 375. For a discussion of the debates regarding disclosure of APA materials prior to their specific exclusion, see John L. Abramic, Note, *Advance Pricing Agreements: Confidential Return Information or Written Determinations Subject to Release*, 76 CHI.-KENT L. REV. 1823 (2001); Kristin E. Hickman, Note, *Should Advance Pricing Agreements Be Published?*, 19 NW. J. INT'L. L. BUS. 171 (1998).

practices are consistent with EC and OECD aims of deterring harmful tax practices and forbidden state aid. As such, the United States promotes fair tax competition in a global market.

*A. U.S. Ruling Practice Consistent with EC Treaty Articles 87, 88, and 89 Relating to Forbidden State Aid*²⁰⁰

The EC, established as a result of the Treaty of Rome (EC Treaty), is charged with "establishing a common market and an economic and monetary union and by implementing common policies or activities to promote throughout the Community" for its overall good.²⁰¹ In doing so, the EC imposes limits on the ability of its member states to tax²⁰² one another.²⁰³ The United States administers a single, highly publicized ruling program that is equally applicable to all taxpayers, resulting in a program that promotes fair tax competition consistent with the EC Treaty.

1. Articles 87, 88, and 89 of the EC Treaty described

Article 87 of the EC Treaty sets forth what is compatible and incompatible with the common market.²⁰⁴ Specifically, aid from Member States that

200. Renumbered after the Treaty of Amsterdam, these treaty articles were formerly Articles 92, 93, and 94, respectively, of the EC Treaty.

201. See EC Treaty, *supra* note 6, available at <http://europa.eu.int/abc-en.htm> (last visited Feb. 15, 2002). The fifteen members of the EC include: the original members who joined in 1950 (Belgium, Germany, France, Italy, Luxembourg, and the Netherlands); the members joining in the 1973 accession (Denmark, Ireland, and the United Kingdom); Greece, joining in 1981; Spain and Portugal, joining in 1986; and the members from the last accession in 1995 (Austria, Finland, and Sweden). See DAVID W. WILLIAMS, *EC TAX LAW* (John A. Usher ed., Addison Wesley Longman Inc. 1998).

202. See WILLIAMS, *supra* note 201, at 2. Taxation, as defined by the OECD and International Monetary Fund ("IMF"), is the "levying of compulsory contributions for the benefit of government for which there is not direct return for the payer." *Id.*

203. See WILLIAMS, *supra* note 201, at 1 n.1.

204. See EC Treaty, *supra* note 6, at art. 87. Article 87 provides:

1. Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring [sic] certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.

2. The following shall be compatible with the common market: (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned; (b) aid to make good the damage caused by natural disasters or exceptional occurrences; (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, insofar as such aid is required in order to compensate for the economic disadvantages caused by that division.

3. The following may be considered to be compatible with the common market:

distorts trade competition by favoring activities or the production of certain goods is incompatible.²⁰⁵ Aid that is non-discriminatory and has a social character or is given in response to natural disasters, or for compensation associated with the division of Germany is compatible.²⁰⁶ Other aid that may be (but is not definitively) compatible with the common market includes aid to promote economic development in areas with an abnormally low standard of living; aid that promotes a project of European interest or to remedy a disturbance in the economy; aid to develop economic activities that does not adversely affect trading conditions; aid to promote the conservation of heritage (again, so long as it does not adversely affect trading conditions); and other aid that a qualified majority of the Council of the European Union (Council)²⁰⁷ determines is appropriate.²⁰⁸

Article 88 of the EC Treaty provides that the European Commission (Commission)²⁰⁹ shall review aid given both to and by Member States and propose any changes necessary to ensure the functioning of the common market.²¹⁰ If the Commission finds that, after giving notice to the involved

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest; (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest; (e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.

Id. See text accompanying note 201 (reference to "common market").

205. See *id.*

206. See *id.*

207. See *Charter of Fundamental Rights*, available at <http://europa.eu.int/scadplus/leg/en/cig/g4000c.htm#c33> (last visited Feb. 15, 2002). The Council of the European Union, also referred to as the Council of Ministers, is a single institution and the primary decision making body of the European Union consisting of ministers of the fifteen Member States responsible for the matters on the agenda. See *id.*

208. See EC Treaty, *supra* note 6, at art. 87, para. 3.

209. See *The European Commission*, available at http://europa.eu.int/comm/role_en.htm#4 (last visited Feb. 15, 2002). The European Commission (Commission) represents the general interest of the EU and is responsible for initiating EU policies, ensuring that EU treaties are carried out through subsequent legislation, and managing policies and negotiating international trade agreements. See *id.*

210. See EC Treaty, *supra* note 6, at art. 88, para. 1. Article 88 provides:

1. The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the common market.

2. If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the common market having regard to Article 87

parties, aid granted by a State is incompatible with the common market or is being misused, then the Commission determines that the aid shall cease or be modified within a period of time.²¹¹ Additionally, article 88 also provides an enforcement mechanism if the putative wrongdoer does not comply with the Commission's directives and an application procedure for States to receive a determination that aid granted is compatible with the common market.²¹²

Article 89 of the EC Treaty provides that, after receiving a proposal from a qualified majority of the Commission and consulting with the European Parliament, the Council may promulgate regulations to apply articles 87 and 88 of the EC Treaty, particularly those relating to the Commission's consideration of a State's plan to grant or alter aid under article 88(3).²¹³

[see *supra* note 204], or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission. If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 226 [referral of matters to the Court of Justice if the Commission determines that a Member State has not fulfilled a treaty obligation] and 227 [referral of matters to the Court of Justice after first referring them to the Commission if another Member State has not fulfilled its treaty obligations], refer the matter to the Court of Justice direct. On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered to be compatible with the common market, in derogation from the provisions of Article 87 or from the regulations provided for in Article 89 [see *infra* note 213], if such a decision is justified by exceptional circumstances. If, as regards the aid in question, the Commission has already initiated the procedure provided for in the first subparagraph of this paragraph, the fact that the State concerned has made its application to the Council shall have the effect of suspending that procedure until the Council has made its attitude known. If, however, the Council has not made its attitude known within three months of the said application being made, the Commission shall give its decision on the case.

3. The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate the procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.

Id.

211. *See id.*

212. *See id.*

213. *See* EC Treaty, *supra* note 6, at art. 89. Article 89 provides:

The Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 87 [see *supra* note 204] and 88 [see *supra* note 210] and may in particular determine the conditions in which Article 88(3) shall apply and the categories of aid exempted from this procedure.

Id.

2. U.S. practice consistent with articles 87, 88, and 89

The United States advance ruling practice does not conflict with the forbidden State aid provisions in the EC Treaty. As previously discussed,²¹⁴ article 87 distinguishes between acceptable and unacceptable State aid in the EC that distorts trade competition. When analyzing the acceptability of State aid under article 87, the focus is on the effect of the aid and the social purpose being advanced.²¹⁵ Similarly, advance rulings in the United States that are favorable to taxpayers are issued only if the underlying transactions are lawful. Practices that distort trade or interfere with trade competition conflict with United States policy.²¹⁶ Therefore, a favorable ruling would not be issued under such practices.

In the United States, aid granted to or received by a state that impermissibly discriminates would likely be challenged under one of three provisions of the Constitution: the Spending Clause, the Commerce Clause, or the Privileges and Immunities Clause. The Spending Clause allows Congress to spend, but not regulate, for the general welfare of the nation.²¹⁷ The Commerce Clause vests the power to regulate trade among the states with Congress to ensure uniformity and to avoid embarrassing and destructive consequences that result from conflicting state regulations.²¹⁸ When Congress has not acted, state regulation of interstate or foreign commerce is implicitly limited through the "dormant" or "negative" commerce clause.²¹⁹ The

214. See *supra* notes 204-208 and accompanying text (discussing permissible and impermissible State aid under the EC Treaty).

215. See *supra* notes 207-208 and accompanying text (illustrating that aid given to advance social purposes or stimulate economic development in disadvantaged areas is permitted).

216. See, e.g., 15 U.S.C. § 8 (2001) (prohibiting agreements made to restrain free competition in lawful trade of items to be imported into the United States); *Oregon Waste Sys., Inc. v. Dept. of Env'tl. Quality*, 511 U.S. 93, 99 (1994) (stating that laws of individual states in the United States that restrict interstate commerce are *per se* invalid unless the state can demonstrate that the law advances a legitimate, nondiscriminatory purpose and that the law is the least restrictive means to accomplish that purpose); *Steele v. Bulova Watch Co.*, 344 U.S. 280, 286 (1952) ("Congress has the power to prevent unfair trade practices in foreign commerce by citizens of the United States, although some of the acts are done outside the territorial limits of the United States.") (quoting *Branch v. FTC*, 141 F.2d 31, 35 (7th Cir. 1944)).

217. See U.S. CONST. art. I, § 8. Congress's authority to spend is under the general welfare clause of the United States Constitution: "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States." *Id.* at cl. 1.

218. See U.S. CONST. art. I, § 8. The Commerce Clause empowers Congress, the legislative branch of government, with the exclusive authority to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." *Id.* at cl. 3. See ARVO VAN ALSTYNE ET AL., *SUM & SUBSTANCE OF CONSTITUTIONAL LAW* §§ 5.1000, 5.1200 (4th ed. 1986) [hereinafter *SUM & SUBSTANCE*]. Courts have interpreted the Commerce Clause as a limitation on state power. See *id.* § 5.1210.

219. See CALVIN R. MASSEY, *CONSTITUTIONAL LAW*, 147 (1997) [hereinafter *CONSTITUTIONAL LAW*].

Privileges and Immunities Clause prohibits a state's discrimination of non-residents in favor of its own citizens without permitted justification.²²⁰

Impermissible aid granted by the federal government to states would be analyzed under the Spending Clause, under which Congress often uses its authority to impose conditions on state action.²²¹ However, conditions on spending must meet three requirements: they must be in pursuit of the "general welfare" of the United States;²²² unambiguous, so states may exercise their choice knowingly; and reasonably further some national project or program otherwise within federal power.²²³ These limitations, along with the fact that federal legislation must be passed by a majority of representatives from all states, prevent the likelihood that impermissible, discriminatory state aid that does not advance a generally accepted social policy will be given.

Impermissible aid provided by individual states would be challenged under the Commerce Clause or the Privileges and Immunities Clause. Under the Commerce Clause, all state laws affecting trade that do not conflict with federal laws must be rationally related to a legitimate state purpose.²²⁴ State laws that promote local commercial purposes tend to violate free trade and are impermissible. Regulations advancing local health, safety, and welfare tend not to violate free trade and are therefore permissible.²²⁵ In addition, courts

220. See U.S. CONST. art. IV, § 2, cl. 1. The Privileges and Immunities Clause provides: "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." *Id.* Note that this clause only applies to natural persons, not business entities. See VAN ALSTYNE, *supra* note 218, § 6.4200 (citing *Paul v. Virginia*, 148 U.S. 107 (1869)). Although not related to market participation, a state may restrict privileges such as voting in local elections to its citizens. See *id.* § 6.4210 (citing *Martinez v. Bynum*, 461 U.S. 321 (1983)).

221. See, e.g., *United States v. Butler*, 291 U.S. 1, 68 (1936) (Congress's attempt to raise farm prices by limiting production under the Agriculture Adjustment Act was beyond its spending power because it was regulating, rather than spending, for the general welfare); *Steward Mach. Co. v. Davis*, 301 U.S. 548, 598 (1937) (conditioning a state's receipt of a payroll tax credit on a state's compliance with minimum funding requirements is valid under spending clause); *South Dakota v. Dole*, 483 U.S. 203 (1987) (holding withholding federal highway funds otherwise due under other federal laws from any state permitting persons under age twenty-one years from buying or possessing alcoholic beverages was a valid exercise of Congress' spending power).

222. See MASSEY, *supra* note 219, at 129 (citing *South Dakota v. Dole*, 483 U.S. 203, 206 (1987)). The limitation that conditions on federal spending must be in pursuit of general welfare is not meaningful because courts "defer substantially to the judgment of Congress." *Id.*

223. See *id.* This spending can be for any purpose necessary or proper to benefit the general public; it is not restricted to effectuate an enumerated power of the federal government. See *id.* at 127 (citing *United States v. Butler*, 291 U.S. 1 (1936)).

224. See *id.* at 147. Economic protection, alone, is not a sufficiently legitimate state purpose. See *id.*

225. See VAN ALSTYNE, *supra* note 218, § 5.1330 (citing *Gibbons v. Ogden*, 22 U.S. 1 (1824) (distinguishing a state's police power from Congress's authority to regulate commerce) and *Willson v. Black-Bird Creek Marsh Co.*, 27 U.S. 245, 249 (1829) (noting that state restrictions to protect health and safety are within the power of the states, provided that they do not interfere with the powers of the general government)).

may review the practical effect of the state regulation being challenged; if it discriminates against or imposes an undue burden upon commerce, then it is not permitted.²²⁶ The purpose behind analyzing state legislation under the Commerce Clause in this manner has been summarized as follows:

Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.²²⁷

States are exempt from the restrictions imposed by the dormant commerce clause when acting as market participants (rather than as market regulators).²²⁸ States act as market participants when they engage in or create commerce; similar to private parties, they may discriminate in favor of their own residents in interstate commerce.²²⁹ Therefore, under the market-participant exception to the dormant commerce clause, a state may provide favorable treatment to its residents when awarding state contracts and the like. However, this occurrence is beyond the scope of the federal tax-ruling program in the United States.

The final, most likely constitutional ground upon which state aid may be challenged is under the Privileges and Immunities Clause, which prohibits discrimination by a state against non-citizens.²³⁰ States are only mandated to treat citizens and non-citizens similarly under this clause when fundamental interests are concerned, defined as "those bearing on the vitality of the Nation as a single entity."²³¹ A state is permitted to discriminate based on residency where: "(a) there is substantial reason for the difference in treatment; and (b)

226. *See id.* §§ 5.1350, 5.3000, 5.4000. State laws that facially discriminate against interstate commerce are invalid unless they advance legitimate objectives that cannot be achieved through less discriminatory means. *See MASSEY, supra* note 219, at 147.

227. *H. P. Hood & Sons v. DuMond*, 336 U.S. 525, 539 (1949). However, these decisions are inconsistent in both their doctrinal approach and in their holdings because they are (and should be) analyzed considering their particular factual circumstance. *See VAN ALSTYNE, supra* note 218, § 5.1300.

228. *See MASSEY, supra* note 219, at 148.

229. *See id.* at 166 (citing *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980)).

230. *See VAN ALSTYNE, supra* note 218, § 6.4200. Although not related to market participation, a state may restrict privileges such as voting in local elections to its citizens. *See id.* § 6.4210 (citing *Martinez v. Bynum*, 461 U.S. 321 (1983)).

231. *See id.* § 6.4200 (quoting *Baldwin v. Fish and Game Comm'n*, 436 U.S. 371 (1978)).

that difference in treatment bears a close and substantial relationship to the state's objective."²³² This discrimination is permitted because state residents have a special interest in local public resources, because they support them by paying local taxes.²³³ However, the restriction may not be overwhelmingly restrictive and is impermissible when it extends beyond what is reasonable or involves a fundamental right.²³⁴

The previous three Constitutional doctrines provide the foundation upon which state aid in the United States would be analyzed. These doctrines are consistent with article 87 of the EC Treaty. It is unlikely, however, that this state aid analysis is affected by the federal tax ruling program in the United States because, as discussed previously,²³⁵ federal tax rulings are generally issued to private taxpayers, not government entities.

Although no corollary exists in the United States advance ruling program, the practices sought to be eliminated in article 88 are deterred in the United States, primarily, through independent judicial review of the activity; secondarily, through legislation. As discussed above, article 88 outlines general provisions to review aid given to or from Member States to ensure common market functioning. In the United States, individual states and taxpayers may challenge aid granted to or from another state by initiating a

232. *Id.* § 6.4300 (quoting *New Hampshire v. Piper*, 470 U.S. 274, 288 (1985)). When considering the latter issue, the least restrictive means must be contemplated. *See id.*

233. *See id.* § 6.4300 (citing *New Hampshire v. Piper*, 470 U.S. 274 (1985)).

234. *Compare Canadian N.R.R. v. Eggen*, 252 U.S. 553 (1920) (permitting a state to grant more favorable access to courts to residents than non-residents); *Vlandis v. Kline*, 412 U.S. 441 (1973) (stating in dicta that states are permitted to give preferential tuition advantages to local students); *Sosna v. Iowa*, 419 U.S. 393 (1975) (upholding a state's restriction limiting availability of divorce to persons who had been state residents for at least one year), *with Toomer v. Witsell*, 334 U.S. 385 (1948) (taxing residents \$25 for shrimp boat licenses when non-residents were taxed \$2,500 was impermissible because, although the state may charge a higher fee to non-residents, the amount must be reasonable to reimburse the state for additional burdens imposed by enforcing regulations and the difference here was nearly a total exclusion); *Baldwin v. Fish and Game Comm'n*, 436 U.S. 371 (1978) (requiring a state to treat citizens and non-citizens alike only when it pertains to a fundamental interest, defined *supra* in the text accompanying note 231); *Austin v. New Hampshire*, 429 U.S. 656 (1975) (overturning a commuter tax on the income of non-residents earned within the state when there was no corollary tax on either the income of residents earned out of the state or on domestic income of residents because the tax fell exclusively on non-residents' income and was not offset (even approximately) by other taxes imposed on residents alone); *Hicklin v. Orbeck*, 437 U.S. 518 (1978) (overruling a state statute requiring all employers engaged in oil businesses under state oil and gas leases or permits to give preferential treatment to job applicants who were state residents because it was not justified, either by a high state unemployment rate nor by the state's owning the oil that was being extracted and processed); *Supreme Court of N.H. v. Piper*, 470 U.S. 274 (1985) (practicing law was a fundamental right and admission to the state bar could not be denied to a candidate who otherwise met the state requirements because the state interests sought to be protected were not substantial or could be protected by least restrictive means).

235. *See* discussion of rulings in sections I-III, *passim*.

judicial proceeding.²³⁶ Courts are empowered to remedy the situation with both legal and equitable relief, including enjoining the offending state from continuing to provide or receive the aid and awarding monetary damages to the prevailing party. The United States also addresses the practices contemplated by article 88 through legislation. Congress, the law-making branch of the federal government, may enact legislation specifically proscribing the state from giving or receiving the aid under its exclusive authority to regulate interstate commerce.²³⁷

The authority of executive agencies in the United States to issue regulations interpreting statutes is consistent with article 89 of the EC Treaty. Article 89 provides that the Council may issue regulations pertaining to articles 87 and 88 of the EC Treaty, the provisions restricting forbidden State aid.²³⁸ In the United States, executive agencies are authorized to issue regulations (like the provisions in article 89) to interpret Congressional laws so long as procedural requirements are satisfied, such as giving notice of the regulation and an opportunity to comment to the public.²³⁹ As stated above,²⁴⁰ practices that distort trade competition violate United States public policy. The result is that executive agencies in the United States may create regulations that deter harmful tax practices so long as they are issued pursuant to a conferral of Congressional authority.

The forbidden State aid provisions of the EC Treaty are designed to prevent, reduce, and eliminate interference with the common marketplace. Because the United States is one nation with its member states under the control of one common authority, the federal government can—and does—impose rules and standards applicable to the individual states. Congress has preempted the regulation of interstate commerce between the United States and individual states or other countries. Because the trading policy of the United States favors free competition and lawful trade, United

236. To raise a successful claim, the plaintiff must have standing (the person initiating the claim must have a sufficient stake in an otherwise justiciable controversy). This requirement is satisfied if the putative plaintiff has a legally protected and tangible interest in the litigation. See BLACK'S *supra* note 12, at 1405 (citing *Sierra Mountain Club v. Morton*, 405 U.S. 727 (1972) and *Guidry v. Roberts*, 331 So.2d 44, 50 (La.App. 1976)).

237. See VAN ALSTYNE, *supra* note 218 for discussion of Congressional authority under the Commerce Clause.

238. See *supra* note 213 for text of EC Treaty article 89.

239. To summarize the process by which regulations interpreting statutory provisions in the United States are promulgated, legislative regulations must be issued in accordance with the notice and comment requirements of the Administrative Procedure Act. There is no similar requirement for interpretive and procedural regulations, although they are followed for interpretive regulations. Although not affecting the conclusion that United States practice is consistent with Article 89, regulations concerning aid by or to States that interfere with trade practices would likely be promulgated by the Department of Commerce, another executive agency, rather than the Treasury or the IRS.

240. See *supra* note 216 (discussing United States policy regarding practices distorting trade).

States practices comply with those advocated in articles 87 through 89 of the EC Treaty. Similarly, disruptive State aid practices are curtailed in the United States at least as much as the remedies afforded in articles 87 through 89 when claims are initiated through its judiciary branch because relief is both equitable (enjoining the action) and legal (awarding monetary damages). The United States has authority equal to that provided in article 89 to further explain relevant laws. Finally, all executive agencies are vested with authority to promulgate regulations interpreting law within their jurisdiction, including those deterring harmful competition in the marketplace.

B. U.S. Ruling Practice Consistent with EC Code of Conduct

1. EC Code of Conduct described

On December 1, 1997 the Council passed a package of measures to address harmful tax competition that included measures to reduce distortions in the single market, prevent excessive losses of tax revenue, and develop tax structures in employment-friendly manners.²⁴¹ The ECOFIN Council²⁴² and the Representatives of the Governments of Member States agreed to a resolution establishing a code of conduct for business taxation, now commonly referred to as the "EC Code of Conduct."²⁴³

The Code of Conduct (EC Code) identifies potentially harmful business taxing regimes, provides criteria to determine whether a regime is harmful, and includes a commitment both to end existing harmful regimes (the rollback) as well as to not start new ones (the standstill).²⁴⁴ The EC Code specifically applies to tax measures—which includes not only laws and regulations, but also administrative practices—affecting the location of business activity.²⁴⁵ Tax measures of this type that are significantly lower than those generally applicable to Member States are considered potentially

241. See Coraline Kok, *EC Update*, EUROPE. TAX., EC-5, Feb. 1998; see also the OECD 1998 Report. The following three areas were business taxation, taxation of savings income, and withholding taxes on cross-border interest and royalty payments between companies. See Kok, *supra*, at EC-5.

242. See <http://www.eu2001.se/static/eng/issues/ecofin.asp> (last visited Feb. 15, 2002). The ECOFIN Council coordinates economic policy in the EU. In this capacity it has paid particular attention to combating harmful tax competition among countries. See *id.*

243. See Kok, *supra* note 241, at EC-5; OECD 1998 Report, *supra* note 7. The Code of Conduct is intended to apply to "business taxation, taxation of savings income and the issue of withholding taxes on cross-border interest and royalty payments between companies." *Id.*

244. See OECD 1998 Report, *supra* note 7, ¶ 17, at 11. See also Council of European Union and Representatives of the Governments of the Member States, Code of Conduct for Business Taxation *reprinted in* Kok, *supra* note 241, at EC-6 (Annex 1) (hereinafter "EC Code").

245. See Council of European Union and Representatives of the Governments of the Member States, Code of Conduct for Business Taxation *reprinted in* Kok, *supra* note 241, at EC-6 (Annex 1).

harmful.²⁴⁶ Per the EC Code, in determining whether measures are harmful, the following factors should be considered:

- (1) [W]hether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, or
- (2) whether advantages are ring-fenced^[247] from the domestic market so they do not affect the national tax base, or
- (3) whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages, or
- (4) whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD, or
- (5) *whether the tax measures lack transparency, including where legal provisions are relaxed at the administrative level in a non-transparent way.*²⁴⁸

To comply with the provision of the EC Code regarding transparency,²⁴⁹ Member States must inform each other of existing and proposed tax measures that may fall within the scope of the EC Code, especially if requested to do so by a Member State.²⁵⁰

2. U.S. ruling practice consistent with EC Code of Conduct

The advance ruling practice in the United States is consistent with the goals set forth in the EC Code. There are no particular advantages afforded to foreign over domestic taxpayers, or vice versa. Within the ruling program, members of each group are afforded similar treatment so long as there is compliance with the procedures for obtaining rulings. The ruling program does not advance ring-fencing—restricting a preferential taxing regime to non-residents or isolating it from the domestic economy—because, again, there is no advantage in the U.S. advance ruling program afforded to either foreign or domestic taxpayers. Because of the specific information, supporting

246. *Id.*

247. See *infra* note 264 and accompanying text (discussing “ring-fencing”).

248. Council of European Union and Representatives of the Governments of the Member States, Code of Conduct for Business Taxation *reprinted in* Kok, *supra* note 241, at EC-6 (Annex 1) (emphasis added).

249. See *infra* notes 265-277, 279-282 and accompanying text for a discussion of transparency. Although within the context of OECD provisions, the discussion of transparency applies equally to the EC Code of Conduct. See *id.*

250. See Council of European Union and Representatives of the Governments of the Member States, Code of Conduct for Business Taxation, E. *reprinted in* Kok, *supra* note 241, at EC-6 (Annex 1).

documentation, and penalty of perjury statements that must accompany requests for rulings, the likelihood that advantageous rulings are granted to individuals or entities without real economic activity and substantial economic presence is minute. The stringent disclosure requirements imposed by section 6110 and the Freedom of Information Act further contribute to the unlikely result that certain taxpayers would receive advantages over others. Finally, the EC Code rules regarding transfer pricing and transparency are substantially similar to those set forth in the OECD 1998 Harmful Tax Competition: An Emerging Global Issue Report (OECD 1998 Report) discussed below.

C. U.S. Ruling Practice Consistent With OECD Tax Competition Report (OECD 1998 Report)

The OECD 1998 Report promotes a uniform application of tax laws among taxpayers; nondiscriminatory rules—both in form and in application—that are publicized, widely available and consistently applied; and publicized transfer pricing guidelines based on arm's length transactions. The ruling program and transfer pricing agreements in the United States are consistent with OECD recommendations because they are widely disclosed and equally applied.

1. OECD 1998 Report

The OECD is an international organization established in 1960 to promote policies whose objective are three-fold:

[First,] to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy; [second,] to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and [third,] to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.²⁵¹

251. Organisation for Economic Co-Operation and Development, OECD's Project on Harmful Tax Practices: The 2001 Progress Report 2, available at <http://www.oecd.org/pdf/m00021000/m00021182.pdf> (last visited Feb. 14, 2002) [hereinafter OECD 2001 Progress Report]. See also <http://www.oecd.org/oeecd/pages/home/displaygeneral/0,3380,EN-home-0-nodirectorate-no-no-no-0,FF.html> (stating OECD mission as assisting member countries to address economic, social, and governance problems inherent with a global economy) (last visited Feb. 14, 2002). The OECD's membership consists of the European Union ("EU") and the European Economic Area (EEA) except Liechtenstein. See WILLIAMS, *supra* note 201, at 10 n.17. The thirty members of the OECD are: (1) Australia, (2) Austria, (3) Belgium, (4) Canada, (5) the Czech Republic, (6) Denmark, (7) Finland, (8) France, (9) Germany,

It accomplishes these goals by identifying and responding to emerging issues through internationally agreed upon recommendations, including inter-governmental reports on tax policy and practice developed by the OECD Committee on Fiscal Affairs.²⁵² These reports result from regular, ongoing discussions and information exchanges among countries about issues associated with direct and value-added taxation.²⁵³

In response to a directive by the OECD Ministers to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases," in 1998 the Committee on Fiscal Affairs (Committee) issued the OECD 1998 Report.²⁵⁴ This report served as a vehicle for OECD members to better understand the effect of harmful tax practices on the location of financial and other service activities; the erosion of tax bases of other countries; the distortion of trade and investment patterns; and on undermining the fairness, neutrality, and social acceptance of tax systems generally.²⁵⁵ The report and its accompanying recommendations were approved on April 9, 1998.²⁵⁶

(10) Greece, (11) Hungary, (12) Iceland, (13) Ireland, (14) Italy, (15) Japan, (16) Korea, (17) Luxembourg, (18) Mexico, (19) the Netherlands, (20) New Zealand, (21) Norway, (22) Poland, (23) Portugal, (24) the Slovak Republic, (25) Spain, (26) Sweden, (27) Switzerland, (28) Turkey, (29) the United Kingdom, and (30) the United States. See <http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-countrylist-0-nodirectorate-no-no-159-0,FF.html> (last visited Feb. 14, 2002). The OECD has no executive powers and only operates through unanimity. See WILLIAMS, *supra* note 201, at 11. Because it only makes recommendations, the OECD is regarded as a safe forum through which members can discuss taxation problems. See *id.* Additionally, the OECD affords the opportunity for discussions with all leading economic nations, rather than just those in Europe. See *id.*

252. See *id.* This is only one of the three ways the OECD is primarily active; the OECD also produces and maintains the OECD Model Tax Convention on Income and Capital and conducts outreach to member and nonmember countries. See *id.*

253. See *id.*

254. See OECD 1998 Report, *supra* note 7, at 3.

255. See *id.* ¶ 4, at 8. The end result the OECD hopes to achieve with its focus on harmful tax competition is to promote an open, multilateral trading system and encourage adjustments to the system to contemplate the changing nature of international trade, investment, and taxation. See *id.* ¶ 8, at 9. The guidelines contained in the OECD 1998 Report are compatible with the EC Code (see *supra* section IV.B), as they identify harmful tax competition similarly. See *id.* However, they differ in that the OECD Guidelines are limited to financial and other service activities, whereas business activities in general are examined in the EC Code (see *supra* this note). See *id.* Finally, unlike the EC Code, the review procedure in the OECD is directed toward a broader geographic group, it includes tax havens when considering harmful tax practices, and it focuses on the exchange of information. See *id.* ¶ 18, at 11.

256. See OECD Releases Progress Report on Addressing Harmful Tax Practices, n.1 at http://www.oecd.org/oecd/pages/document/print_template/0,3371,EN-document-notheme-1-no-no-21176-0-withoutnav,00.html (last visited Feb. 14, 2002). Luxembourg and Switzerland, who initially abstained, later rescinded their abstentions to the 1998 Report. See *id.*

The report focuses on “harmful tax practices,” a phrase that collectively refers to tax havens and countries with potentially harmful tax regimes.²⁵⁷ “Tax havens” are defined in the 1998 Report as countries “able to finance their public services with no or nominal income taxes and that offer themselves as places to be used by non-residents to escape tax in their country of residence”²⁵⁸ Tax havens differ from “countries with potentially harmful tax preferential tax regimes” because, in countries with potentially harmful preferential tax regimes, significant revenue is raised from income taxes; their tax systems, however, have features that promote harmful tax competition.²⁵⁹ These distinctions are relevant because the Committee concluded that tax haven jurisdictions are likely not willing to cooperate in eliminating harmful tax competition, whereas countries with potentially harmful tax preferential regimes were more likely to cooperate with the OECD agenda.²⁶⁰

Classification of the effects of tax practices as harmful is made after evaluating all relevant factors.²⁶¹ The chief considerations to determine the existence of a tax haven include: whether there is a low or nonexistent tax rate on relevant income; whether the country offers itself as, or is perceived to be, a jurisdiction where non-residents can escape taxation by their resident country; and whether limitations exist on the ability of other countries to obtain information relevant to tax purposes.²⁶² There are four primary considerations when classifying a jurisdiction as a preferential tax regime:²⁶³ (1) no or nominal tax on relevant income; (2) the regime is restricted to non-

257. See OECD 1998 Report, *supra* note 7, ¶ 4, at 8.

258. *Id.* ¶ 42, at 20.

259. *See id.*

260. *See id.* ¶ 43, at 20.

261. *See id.* ¶ 45, at 21.

262. *See id.* ¶ 46, at 21.

263. See OECD 1998 Report, *supra* note 7, ¶¶ 68-78, at 30-34. In addition to these four primary considerations, other factors may be considered, such as whether there is an artificial definition of the tax base or if the tax base is non-transparent, both of which make it difficult to determine whether all of the companies investing in the country have the same tax rate imposed. *See id.* Another consideration is whether the country fails to adhere to transfer pricing principles (generally relying on the arm's length standard to determine the transfer price but making adjustments given the facts and circumstances of the case). *See id.* Failure to adhere to transfer pricing principles most likely occurs where treatment afforded to a taxpayer is non-transparent, where a taxpayer can negotiate a transfer price, where equal treatment is not embedded in the legal system, or where advance rulings are not appropriately used (such as when agreements are non-transparent, not based on the facts and circumstances, and when guidelines are not followed). *See id.* An additional consideration is whether there is access to a wide network of tax treaties, which may open the benefits of harmful preferential tax regimes offered by the treaty country to a wider array of countries than would otherwise be the case. *See id.* Similarly, other factors include whether the tax rate or tax base is negotiable or whether the rate depends on the residency of the investor, or whether secrecy provisions restricting the access of other governments to relevant tax information exist. *See id.* Other considerations include whether foreign-source income is exempt from country tax, whether regimes are promoted as tax minimization vehicles, and whether the regime encourages purely tax-driven operations or arrangements. *See id.*

residents and isolated from the domestic economy; (3) lack of transparency in legislative, judicial, and administrative provisions; and (4) limited access of resident countries to information on taxpayers benefiting from the potentially preferential tax regime.²⁶⁴ Of these, the third factor, transparency, is primarily relevant to tax rulings.

"Lack of transparency" is a broad concept that refers to how a taxing regime is designed and administered and includes: favorable application of laws and regulations, negotiable tax provisions, and a failure to make administrative practices widely available.²⁶⁵ To be considered transparent, a tax regime's administration should set forth the conditions applicable to taxpayers so that the conditions may be invoked against the authorities; details of the regime, including those details applicable to a particular taxpayer, should be available to tax authorities of other countries.²⁶⁶ A lack of transparency may result because favorable administrative rulings are provided, allowing some taxpayers to operate under a lower effective tax than others.²⁶⁷ Criteria necessary to obtain a ruling should be available in a non-discriminatory manner to all taxpayers.²⁶⁸

Similarly, non-transparency can exist in jurisdictions that employ special administrative policies contrary the jurisdiction's statutory procedures.²⁶⁹ For example, a jurisdiction may have a statutorily prescribed fixed tax rate and base but the jurisdiction's administrative practice does not conform to the statutory rules or is not consistently applied.²⁷⁰ Such an administrative practice may result in corruption and discrimination, especially if these administrative practices are not disclosed.²⁷¹

Finally, non-transparency can exist if laws in an otherwise legitimate regime are not enforced.²⁷² For example, the tax authorities may intentionally follow a lax audit policy to implicitly invite taxpayers not to comply with tax laws that otherwise conform to the OECD rules, resulting in affording these taxpayers a greater competitive advantage.²⁷³

In its 2001 Progress Report, the Committee explained that the objective of having tax haven jurisdictions comply with transparency criteria was to ensure that "laws are applied on an open and consistent basis among similarly situated taxpayers, and . . . information needed by tax authorities to determine

264. *See id.* ¶ 46, 53, at 21, 23-24. The second consideration is referred to as "ring-fencing." *See id.* ¶ 46, at 21.

265. *See id.* at 27 Box II(c).

266. *See id.* ¶ 63, at 28.

267. *See id.* These administrative practices are viewed as legitimate and necessary exercises of administrative authority when they are consistent with statutory laws. *See id.*

268. *See* OECD 1998 Report, *supra* note 7, ¶ 63, at 29.

269. *See id.*

270. *See id.*

271. *See id.*

272. *See id.*

273. *See id.*

a taxpayer's situation is in place."²⁷⁴ Lack of transparency also exists when there is "inadequate regulatory supervision or if the government does not have legal access to financial records."²⁷⁵ Tax authorities are unable to apply laws effectively and fairly when the system is not transparent.²⁷⁶ Examples of abuses that result in a non-transparent system include secret rulings and negotiated tax rates, which do not apply the law openly and uniformly.²⁷⁷

The Committee made a series of recommendations that countries ameliorate harmful tax competition by adopting measures consistent with its findings and its goal of reducing harmful tax competition, first through unilateral measures, then bilateral agreements negotiated in the form of tax treaties, followed by multilateral responses.²⁷⁸ Of those recommendations, one that pertains to rulings suggests that countries providing agreements in advance of a planned transaction make the conditions for denying, granting, or revoking such decisions available to the general public.²⁷⁹ Publication of these conditions includes making details concerning how the taxpayers' positions are determined (such as the arm's length value of services or profits and losses) known so that the same rules are applied to all taxpayers.²⁸⁰ Further, if procedures for obtaining advance agreements are not widely known, then taxpayers may be treated unequally because the lack of public information may put taxpayers in different positions when determining their tax situation.²⁸¹ Finally, if the substantive and procedural conditions for granting or denying individual tax rulings are published, then greater transparency of tax policies is ensured.²⁸²

Regarding transfer pricing, the Committee recommended that countries follow the OECD's 1995 Guidelines on Transfer Pricing (OECD 1995 Guidelines) and refrain from applying transfer pricing rules that would constitute harmful tax competition.²⁸³ The 1995 Guidelines set forth the arm's length principle as the general rule.²⁸⁴ Deviations from that principle to make that country a tax-favored intermediary can constitute harmful tax competition.²⁸⁵

274. OECD 2001 Progress Report, *supra* note 251, ¶ 6, at 5.

275. *Id.*

276. *See id.*

277. *See id.*

278. *See id.* ¶ 38, at 91. *See generally id.* ¶¶ 97-171, at 40-62 (enumerating and detailing the Committee's recommendations).

279. *See* OECD 1998 Report, *supra* note 7 ¶ 108, at 44.

280. *See id.*

281. *See id.* ¶ 109, at 44-45.

282. *See id.* ¶ 110, at 45.

283. *See id.* ¶¶ 111, 166-67 at 45, 61.

284. *See id.* ¶ 111, at 45.

285. *See* OECD 1998 Report, *supra* note 7, ¶ 111, at 45.

2. *U.S. ruling program complies with relevant provisions of the OECD 1995 and 1998 Reports*²⁸⁶

As noted above,²⁸⁷ the primary condition in the OECD 1998 Report for determining whether a ruling program contributes to a jurisdiction's classification as a preferential tax regime is whether the country's practices are transparent.²⁸⁸ Transparency is evaluated by reviewing whether legislative, judicial, and administrative rules of the country considered to ensure that the procedures for obtaining rulings are published, that taxpayers' rights are publicized, that those procedures are non-discriminatorily applied, that information regarding the underlying transaction can be verified, and that the substance of the transaction is made available (including to authorities in other countries). The jurisdiction must also follow its announced policies when issuing rulings, as well as when applying other tax laws that give advance rulings effect (such as following through with audit procedures to verify that taxpayers are complying with the rules prescribed in the tax system).

The APA program in the United States conforms to the standards advanced by the OECD. Like all other advance rulings in the United States, the procedures for obtaining an APA are highly publicized. The likelihood for discrimination in administration of the APA process is mitigated²⁸⁹ by the use of APA teams, competent authority provisions, and the taxpayer's ability to withdraw APA requests and challenge any adverse determinations on audit through the independent judicial system. The possibility that an APA will be granted on fictitious transactions is greatly reduced because of the substantial documentation required, as well as the cost of seeking an APA. Also like other rulings, threats that the IRS will not adhere to the policies announced are slight, given the administrative checks on agencies of government.

286. Although outside the scope of this paper, the OECD 2000 Report classified the U.S. Virgin Islands, an external territory of the United States, as a tax haven and the United States treatment of foreign sales corporations (FSCs) as a "preferential tax regime that is potentially harmful." See Organisation for Economic Co-Operation and Development, Towards Global Tax Co-operation Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs—Progress in Identifying and Eliminating Harmful Tax Practices 14 (foreign sales corporation), 17 (U.S. Virgin Islands), available at <http://www.oecd.org/pdf/m000014130.pdf> (last visited Feb. 14, 2002) [hereinafter OECD 2000 Report].

287. See *supra* text following note 264.

288. Another factor considered when classifying a jurisdiction as engaging in harmful tax practices—the extent to which resident countries have access to information about taxpayers benefiting from the potentially preferential tax regime—is considered in the context of transparency only.

289. See OECD's 1995 Guidelines on Transfer Pricing (OECD 1995 Guidelines). Although applying specifically to APAs and not advance rulings in general, the OECD recommends that countries subscribe to the "arm's length" standard when determining pricing of inter-company transfers. See *id.* Consistent with this recommendation, the APA program in the United States uses the arm's length standard as its initial starting point when making pricing agreements. See *id.*

V. CONCLUSION

The EC and the OECD are committed to promoting fair tax competition.²⁹⁰ The tax ruling practice in the United States is consistent with this goal, as is apparent when analyzing the system in the United States with the EC and OECD criteria enunciated in the EC Treaty, the EC Code of Conduct, and the OECD Tax Competition Report.

The EC Code and the OECD recognize and are committed to ending harmful tax regimes.²⁹¹ A regime is determined harmful by reviewing whether residents and similarly situated non-residents are treated equally, whether information is available, whether favorable rulings are issued when transactions lack economic substance, whether transfer pricing rules comply with OECD standards, and whether tax measures are transparent.²⁹² If these criteria are satisfied, then a regime does not promote harmful tax competition under the EC and OECD models.

Although all factors are important, transparency is most relevant to tax rulings. To be transparent, procedures to obtain rulings should be clearly announced, details of the tax regime should be available to tax authorities of other countries, favorable rulings should be equally applicable to all similarly situated taxpayers, audit procedures should be utilized, and remedies against authorities should be afforded.²⁹³

The United States ruling practice is largely consistent with EC and OECD goals for ending harmful tax practices. The ruling program is designed so that formal, generally applicable rulings are applied equally to similarly situated taxpayers. If they are not, then procedural safeguards exist, such as administrative and judicial appeals so that aberrations may be challenged. Extensive notice and comment procedures are used prior to implementing generally applicable regulations. When interpreting general rules not made pursuant to these procedures, these rules are given less deference by the courts. Although the IRS may retroactively modify or revoke these rules—potentially allowing unfairness—this potential is tempered by the infrequency of retroactive application.

Formal, tailor-made rulings also comply with EC and OECD objectives. Ruling determinations are based on objective criteria, deterring potential discrimination between or among taxpayers. If the objective criteria are not

290. *See generally supra* section IV (discussing U.S. advance rulings in the context of EC and OECD standards).

291. *See generally supra* section IV.B & C (discussing U.S. advance rulings in the context of EC Code and OECD standards).

292. *See generally supra* section IV.B & C (discussing U.S. advance rulings in the context of EC Code and OECD standards).

293. *See generally supra* section IV.B & C (discussing U.S. advance rulings in the context of EC Code and OECD standards).

adhered to, taxpayers are afforded administrative and judicial appeal rights. Rulings are disclosed for review after confidential information has been redacted, making the information available to the public. Because of the substantial documentation that is required when submitting a ruling request, it is unlikely that rulings may be issued on transactions lacking economic substance. Finally, transfer pricing rules in the United States are based on an arm's length standard, the same as that recommended by the OECD.²⁹⁴ The result is that advance rulings in the United States—PLRs and APAs—are consistent with EC and OECD recommendations for promoting fair tax practices in a global marketplace and may serve as a model for other countries developing and reforming their ruling programs.

294. See generally *supra* section IV.B & C (discussing U.S. advance rulings in the context of EC Code and OECD standards).