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INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR BERNARD B. NELSON
AREA COUNSEL (LMSB)
NATURAL RESOURCES

FROM: Joseph E. Conley
Acting Chief, Branch 1 (Disclosure and Privacy Law)
CC:PA:DPL:01

SUBJECT: Request for Chief Counsel Advice

This Chief Counsel Advice responds to your memorandum dated March 8, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

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ISSUES 1. Would it violate I.R.C. § 6103(a) to disclose to A documents originally obtained by the A examiner from the G examiner who obtained them as part of the examination of a lease stripping transaction involving G's subsidiary, H, with corporation S?

2. Would it violate I.R.C. § 6103(a) to disclose to A, and use in A's proceeding, the promotional booklets prepared by F that were obtained by the A entities examiner (from the W examiner) after they initiated the proceeding in District Court?

3. Would it violate I.R.C. § 6103(a) for the examiner of A to obtain copies of documents pertaining to the II and JJ transactions from the file of the examiner of

corporation I, disclose the documents to A, and use the documents in A's proceeding?

4. Would it violate I.R.C. § 6103(a) for the administrative files and records of the M and N partnership examinations to be disclosed to A and used in A's proceeding?

5. Would it violate I.R.C. § 6103(a) for the records of R pertaining to the FF transaction, obtained by the Y examiner by third-party contact during the Y examination, to be disclosed to A and used in A 's proceeding?

6. Would it violate I.R.C. § 6103(a) to disclose to the A entities the records pertaining to the HH transaction that were obtained by the examiner of AA?

7. Would it violate I.R.C. § 6103(a) to disclose to A documents pertaining to the O partnership's participation in the lease-stripping transactions identified above that were obtained by the examiner of AA?

8. Would it violate I.R.C. § 6103(a) to disclose to the A entities a document that referred to the separate investment that involved F, AA and an A entity?

9. Is it permissible for the examiner of A to continue gathering records after the District Court petitions are filed, for use in the litigation, from an examiner assigned to audit one of the parties to the lease-stripping transactions that generated the basis in the preferred stock that was acquired by the A entities?

10. If it is permissible for the examiner of A to gather the records identified above, may the records be disclosed to A?

11. Must all documents relating to the underlying lease-stripping transactions in the Service's possession be produced in response to a broad discovery request?

12. Are the closing agreements relating to S and U, as they relate to the underlying lease-stripping transactions, protected from disclosure in response to a discovery request by the A entities?

CONCLUSIONS

1. I.R.C. § 6103(h)(1) authorizes A's[1] examination team to obtain from sources within the Service, such as other examination teams or issue specialists,

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[1]Unless context indicates otherwise, a reference to A's examination or examination team includes the examination and examination team of A and the tiered partnership entities under A collectively. Similarly, a reference to A's proceeding includes the proceedings of the tiered partnership entities collectively.

information relating to the specific lease-stripping transactions to which A's basis in the preferred stock in controversy is traceable. A's examination team has a need to know the information to perform a tax administration function. Furthermore, under I.R.C. § 6103(h)(4)(B) or (C), third party tax information that directly relates to a transactional relationship between A and those third parties which directly affects the resolution of an issue in A's judicial tax proceeding may be used in the proceeding. Such use would include release to a taxpayer as part of an examination or production to an opposing party in litigation as part of discovery. Given that A's basis in the preferred stock is directly related to the transactional relationship between A and those third parties (such as G, H, and S) who engaged in the lease-stripping transactions, the documents of G, H and S, to the extent they concern the relevant lease-stripping transactions, may be disclosed and used under I.R.C. § 6103(h)(4)(B) and/or (C). To the extent that the documents contain information that is not related under I.R.C. § 6103(h)(4)(B) and/or (C), the documents must not be disclosed or used.

2. In order to determine the proper tax treatment of A's preferred stock, the basis of the preferred stock must be traced back to the original lease-stripping transactions that led to the issuance of such preferred stock. F's promotional efforts are central to understanding these transactions. As the promotional materials prepared by F to market the lease-stripping transactions are directly related to the transactional relationship between A and those third parties who participated in the lease-stripping transactions, under I.R.C. § 6103(h)(4)(B) and/or (C), such materials may be disclosed and used in A's proceeding.

3. As with conclusion 1 above, I.R.C. § 6103(h)(1) authorizes A's examination team to obtain from sources within the Service, such as other examination teams or issue specialists, information relating the specific lease-stripping transactions to which A's basis in the preferred stock in controversy is traceable. Further, as with other conclusions stated above, the direct transactional relationship of the preferred stock to the prior lease-stripping transactions permits third party tax return information to be disclosed and used under I.R.C. § 6103(h)(4)(B) and/or (C).

4. Under I.R.C. § 6103(h)(4)(B) and/or (C), the administrative files and records from the partnership examinations of third parties such as M and N may be disclosed and used, but only to the extent that such files and records contain information that directly relates to a transactional relationship between A and those third parties which directly affects the resolution of an issue in A's proceeding. Accordingly, to the extent such files and records contain third party return information necessary for tracing A's basis in the preferred stock, they may be used. Third party return information that does not relate to tracing the basis in the preferred stock may not be disclosed and used under I.R.C. § 6103(h)(4)(B) and/or (C).

5. As with conclusion 4 above, records of R pertaining to the FF transaction obtained by the Y examiner may be used and disclosed under I.R.C. § 6103(h)(4)(B) and/or (C), but only to the extent that they contain information necessary for determining the basis in the preferred stock held by A.

6. The HH lease-stripping transaction differs from the others in that it was aborted before K or L was able to take back preferred stock in a transaction involving a transfer of its leasehold interest. As no preferred stock was issued to either K or L, such stock was not transferred to A. As no stock was transferred to A, there is no transactional relationship involving A and the parties to the HH transaction. As there is no transactional relationship involving A, I.R.C. § 6103(h)(4)(B) and/or (C) do not apply to any information pertaining to the HH transaction. If you seek to use such information in A's proceeding, it should be subpoenaed as part of A's case.

7. As with conclusions 1 through 5 above, documents obtained by AA's examiner that pertain to the O partnership's participation in the lease-stripping transactions identified above qualify for use and disclosure under I.R.C. § 6103(h)(4)(B) and/or (C). Conversely, documents obtained by the examiner regarding the O partnership that do not relate to the lease-stripping transactions involving A do not qualify under I.R.C. § 6103(h)(4)(B) and/or (C) and can only be used or disclosed to the extent that some other exception to I.R.C. § 6103(a) applies.

8. Third party information regarding the separate investment among F, AA and the A entity qualifies for use and disclosure in A's proceeding under I.R.C. § 6103(h)(4)(B) and/or (C) to the extent it directly affects the resolution of an issue in A's judicial tax proceeding.

9. The A examiner may continue to gather records during the pendency of the District Court case from inside the IRS.

10. Records obtained by the A examiner that contain third party information may only be disclosed to A to the extent that I.R.C. § 6103(h)(4)(B) and/or (C) apply. Determining the application of I.R.C. § 6103(h)(4)(B) and/or (C) requires applying facts concerning the records and how they relate to the relevant transactions.

11. The United States cannot provide information in response to a discovery request if such information is protected by I.R.C. § 6103(a), subject to all of the section's exceptions, including I.R.C. § 6103(h)(B) and (C). Third party information must be produced in discovery only to the extent that it qualifies under I.R.C. § 6103(h)(4)(B) or (C) (or another exception to section 6103, if applicable).

12. As with conclusion 11 above, third party information must be produced in discovery only to the extent that it qualifies under I.R.C. § 6103(h)(4)(B) and/or (C). It is unlikely that any information in the closing agreements can qualify under I.R.C.

§ 6103(h)(4)(B) or (C) because the issue in the proceeding is the correct tax treatment of the transaction, not how the Service treated another party to the transaction. As such, information in the closing agreements will likely not directly affect the resolution of an issue in A's proceeding.

FACTS: The facts, as we understand them, are based on information Associate Area Counsel (Natural Resources) received from the examination of A, B, C, D, and E, which are multi-tiered partnerships, and from examinations of other entities who participated in a series of lease-stripping transactions at issue. A key issue involved is the basis of different issues of preferred stock that came to be held by one of the partnerships. The lease-stripping transactions at issue involve a multitude of parties and a number of steps.

- During years 1, 2 and 3, F arranged a number of lease-stripping transactions involving various tangible assets. These lease-strips are identified as CC, DD, EE, FF, GG, HH, II, JJ, KK, and LL.

- Each of the lease-strips consisted of initial lease agreements that were between legitimate lessor corporations, including H, which is a subsidiary of G, and legitimate end-users consisting of various other corporations.

- It is believed that the initial stages of the lease agreements described above were undertaken for legitimate business purposes, but, from these lease agreements, F developed various promotions to strip the income from rent payments and split off the rent deductions to be taken by the sublessors.

- Some of the promotions made by F were done in association with the individual AA, whose corporation BB shared promotional fees with F.

- F's promotional materials patterned the lease-strips similarly for each of what became a number of promotions, as described below.

- One of two foreign limited life companies, K or L, subleased the tangible asset from the primary lessor (such as H).

- K and L were formed with a very small amount of capital, and their only sources of income were fees received for participating in the lease-stripping transactions identified herein.

- One of several domestic limited partnerships (M,N,O,P,Q or R) then subleased the equipment from K or L subject to the end-user leases.

- M, N, O, P, Q or R borrowed an amount of funds to prepay a substantial portion of the rents due under the sublease to K or L, thereby "stripping" the rental income from the sublease.

- One end-user of tangible equipment, corporation I, also served a sublessor on the II and JJ transactions. As sublessor, corporation I made the rent prepayments that stripped the income from the underlying leases. Corporation I received promotional booklets from F in year 2 when the transactions were being structured. These booklets are in the file of the examiner of corporation I.

- K or L invested the prepaid rents in United States Treasury securities.

- A bank guaranteed a portion of the rent which K or L was obligated to pay the primary lessor and took a security interest in the United States Treasury securities.

- F then marketed the leasehold position held by K or L to United States corporations S (through its subsidiary T), U (through its subsidiary V), W (through its subsidiary X), and Y (through its subsidiary Z).

- In transactions intended to qualify for non-recognition treatment under section 351, T, V, X and Z transferred cash to a subsidiary in exchange for the common stock of the subsidiary. K or L contributed the leasehold positions identified above (which included the cash received for prepayment of rent and the obligation to pay rent to the primary lessors) in exchange for preferred stock of the subsidiary. As a result of this transaction, the United States corporations formed in the section 351 transactions claimed entitlement to the rent deductions relating to the equipment.

- One of the lease-stripping transactions, HH, was aborted before preferred stock was issued. In the HH transaction, K acquired the lease interests as with the other transactions, but corporation U decided not to participate in the transaction. Consequently, no preferred stock was issued to K relating to the HH transaction. K had the obligation to pay rent as part of the HH transaction, but never did so, and HH was later nullified by the other parties.

- An employee of A learned that preferred stock created in the section 351 transactions identified above was available for acquisition through F as an intermediary. An agent of F gave an employee of A offering memoranda that F had used to promote two of the lease-stripping transactions. The preferred stock was arguably attractive for acquisition in a partnership transaction subject to section 723 because it had a high basis and low market value.

- Between August of Year 3 and January of Year 4, K and L transferred cash and the preferred stock to partnership D, in exchange for interests in partnership D. On the same day that D received the cash and preferred stock, D transferred it to partnership E as a partnership contribution.

- The cash transferred by K and L to partnership D was borrowed from a foreign partnership affiliated with D. K and L transferred their interests in D to this foreign partnership as security for the loans.

- K and L entered into "put" agreements entitling them to sell their interests in D to C, the general partner of D, on scheduled dates within the following 15-21 months at minimum prices equal to the values of their initial capital accounts. K and L transferred their rights under these "put" agreements to the foreign partnership affiliated with D.

- In an act intended to be consistent with section 723, E reported a tax basis in the preferred stock totaling $a, the same as the total tax basis claimed by K and L. The fair market value of the preferred stock, confirmed by appraisals of a reputable third party, was $b, which was substantially less than 2% of $a.

- In year 4, under the "put" agreement, K sold its partnership interest in D to C. K used the proceeds to repay the loan to the foreign partnership. After this transaction, E sold two blocks of the preferred stock to an outside party, reporting capital losses of $c. We understand that the losses were allocated to C as the transferee-owner of the partnership interest originally held by K, an act that was arguably consistent with Treasury Regulation section 1.704-3(a)(7).

- In year 5, under the "put" agreement, L sold its partnership interest in D to C. L used part of the proceeds to repay the loan to the foreign partnership. The preferred stock obtained from L, however, was never sold at its inflated basis for various reasons.

- An examination of A, B, C, D, and E was commenced in December of year 6. Consistent with Notice 95-53, 1995-2 C.B. 334, the Service challenged the tax results reported from each of the transactions. As agreement could not be reached with A, B, C, D, and E, Final Partnership Administrative Adjustments (FPAAs) were issued to the partnerships for years 3 and 4. Petitions were filed by the Tax Matters Partners for A, B, C, D and E, and, as such, they constitute refund causes of action under the jurisdiction of the Department of Justice.

- The examiner assigned to Y made a third-party contact to R that served as a sublessor on the FF transaction. The documents obtained by the Y examiner from R regarding the FF transaction were not disclosed to Y, but the A examiner has obtained them.

- In addition to the lease-stripping transactions identified above, F and AA entered into a separate financial investment with A. The investment was a complicated one in which A permitted F and AA to purchase a call option through a third party bank that was tied to the performance of one of A's assets in its tiered partnerships. A's representative alleges that this call option investment was directly related to the preferred stock arrangements.

LAW AND ANALYSIS

1. Would it violate I.R.C. § 6103(a) to disclose to A documents originally obtained by the A examiner from the G examiner who obtained them as part of the examination of a lease- stripping transaction involving G's subsidiary, H, with corporation S?

Section 6103(a) prohibits Service employees from disclosing "returns" or "return information" as those terms are defined in Code section 6103(b)(1) and (b)(2), unless disclosure is authorized under a specific provision of Title 26. Code section 6103(b)(2) defines return information to include, among other things, any data which is received by, recorded by, prepared by, furnished to, or collected by the Service with respect to a return or with respect to the determination of the existence or possible existence of liability or the amount of liability of any person under Title 26.

I.R.C. § 6103(h)(1) authorizes the disclosure of returns or return information to officers and employees of the Treasury Department whose official duties requires such disclosure for tax administration purposes. Tax administration is defined as "the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes . . ." I.R.C. § 6103(b)(4). In essence, section 6103(h)(1) authorizes access to information to an employee of the Service when that employee establishes a "need to know" in order to perform a tax administration function. An examination of a taxpayer's tax liability is a tax administration function, as is providing support to the Department of Justice in the course of litigation concerning such taxpayer's tax liability. Under the "need to know" standard of I.R.C. § 6103(h)(1), the A examiner is authorized to receive the documents pertaining to H and S's participation in the lease- stripping transaction.

With respect to disclosures to individuals and entities outside the Service, I.R.C. § 6103(h)(4) is a narrowly tailored exception to the confidentiality requirements of section 6103(a), which authorizes disclosure of certain tax returns and return information in judicial or administrative tax proceedings. Subparagraphs (B) and (C) of section 6103(h)(4) establish item and transaction tests, respectively, under which returns and return information of taxpayers who are not parties to such proceedings may nevertheless be disclosed. Under section 6103(h)(4)(B), a third party taxpayer's returns or return information may be disclosed in judicial or administrative tax proceedings only "if the treatment of an item reflected on such [third party's] return is directly related to the resolution of an issue in the proceeding." Under section 6103(h)(4)(C), a third party taxpayer's returns or return protected information may be disclosed in judicial or administrative tax proceedings only "if such [third party's] return or return information directly relates to a transactional relationship between a person who is a party to the proceeding and the [third party] taxpayer which directly affects the resolution of an issue in the proceeding..."

There are two statutory requirements under section 6103(h)(4)(C) that must be met for third party tax information to qualify for disclosure and use in a tax proceeding. The first requirement is that the third tax party information must relate to a transactional relationship between the taxpayer and the third party. The second requirement is that the information directly affects the resolution of an issue in the proceeding.

Here, the return information of the other parties to the lease-stripping transactions (as it relates to the basis of the preferred stock received by A) meets the first part of the test. The basis of the preferred stock that A received is traceable directly to the lease-stripping transactions. The second requirement of the transactional relationship test is also met as the information directly affects the resolution of an issue in the proceeding. The issue for the proceeding is whether: 1) the lease-stripping transactions were shams so that the basis in the preferred stock would be zero; or 2) if the transactions were not shams, does the proper amount of the basis nonetheless differ from how it was reported.[2]

Thus, under section 6103(h)(4)(B) and/or (C), information relating to the lease-stripping transaction to which A's basis in the preferred stock is traceable that other parties to the lease-stripping transactions provided to the Service in connection with

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[2]While we have analyzed this under the transaction text, it is clear from the legislative history that the same principles would apply to the item test, for example, that the information relate to some dealings or transaction between the parties. See Tavery v. United States, 32 F.3d 1423, 1430 (10th Cir. 1994); Lebaron v. United States, 794 F.Supp 947 (C.D. Cal. 1992).

their own returns or the examination of their returns may be used in A's proceeding and disclosed in discovery.

2. Would it violate I.R.C. § 6103(a) to disclose to A, and use in A's proceeding, the promotional booklets prepared by F that were obtained by the A entities examiner (from the W examiner) after they initiated the proceeding in District Court?

The legal analysis of this issue is largely the same as that for issue 1 discussed above because the key section is 6103(h)(4)(B) and/or (C).

The facts show that F played a central role in facilitating the participation of the various parties in the lease-stripping transactions at issue. An array of critical facts, such as the intent and knowledge of the parties, will be evidenced by F's promotional booklets used in those particular lease-stripping transactions.

Thus, under section 6103(h)(4)(B) and/or (C), F's promotional booklets regarding the lease-stripping transactions to which A's basis in the preferred stock are traceable may be used in A's proceeding and disclosed in discovery.

3. Would it violate I.R.C. § 6103(a) for the examiner of A to obtain copies of documents pertaining to the II and JJ transactions from the file of the examiner of corporation I, disclose the documents to A, and use the documents in A's proceeding?

The legal analysis of this issue is largely the same as that for issue 1 discussed above because the key section is section 6103(h)(4)(B) and/or (C).

Corporation I was not only an end-user of leased equipment, but also served as sublessor on the II and JJ transactions. As sublessor, corporation I made the rent prepayments that stripped the income from the underlying leases.

Thus, under section 6103(h)(4)(B) and/or (C), I's documents relating to the lease-stripping transactions to which A's basis in the preferred stock are traceable may be used in A's proceeding and disclosed in discovery.

4. Would it violate I.R.C. § 6103(a) for the administrative files and records of the M and N partnership examinations to be disclosed to A and used in A's proceeding?

The legal analysis of this issue is largely the same as that for issue 1 discussed above because the key section is section 6103(b)(4)(B) and/or (C).

The administrative files and records from the partnership examinations of third parties such as M and N may be disclosed, but only to the extent that such files and records contain information that directly relates to a transactional relationship between A and those third parties which directly affects the resolution of an issue in A's proceeding.

Accordingly, to the extent such files and records contain third party return information necessary for tracing A's basis in the preferred stock, they may be used. Third party return information that does not relate to tracing the basis in the preferred stock may not be disclosed and used under I.R.C. § 6103(h)(4)(B) and/or (C). Neither section 6103(h)(4)(B) nor (C) permit the disclosure of the returns or return information of unrelated third parties. See S. Rep. No. 94-938, at 325 (1976).

5. Would it violate I.R.C. § 6103(a) for the records of R pertaining to the FF transaction, obtained by the Y examiner by third-party contact during the Y examination, to be disclosed to A and used in A's proceeding?

The legal analysis of this issue is largely the same as that for issue 1 discussed above because the key section is section 6103(b)(4)(B) and/or (C).

The records of R pertaining to the FF transaction obtained by the Y examiner may be used and disclosed under I.R.C. § 6103(h)(4)(B) and/or (C), but only to the extent that they contain information necessary for determining the basis in the preferred stock held by A.

6. Would it violate I.R.C. § 6103(a) to disclose to the A entities the records pertaining to the HH transaction that were obtained by the examiner of AA?

The analysis of this issue differs from issues 1 through 5 above. The facts show that the HH lease-stripping transaction was aborted before K or L took back preferred stock in a transaction involving a transfer of its leasehold interest.

As no preferred stock was issued to either K or L, such stock was not transferred to any of the A entities. As no stock was transferred to A, there is no transactional relationship involving A and the parties to the HH transaction. As a consequence, the first statutory requirement under section 6103(h)(4)(C), that the third tax party information relate to a transactional relationship between the taxpayer and the third party, is not met.[3]

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[3] We assume there is no documentation tying A to the aborted transaction. Such documentation could create the necessary transactional relationship.

As there is no transactional relationship involving A, I.R.C. § 6103(h)(4)(B) and (C) do not apply to any information pertaining to the HH transaction. As such, the records should be re-obtained from AA via a subpoena issued in connection with the A litigation. The records obtained by subpoena in A's litigation are A's return information and may be used and disclosed in the litigation under section 6103(h)(4)(A).

7. Would it violate I.R.C. § 6103(a) to disclose to A documents pertaining to the O partnership's participation in the lease-stripping transactions identified above that were obtained by the examiner of AA?

As with the analysis for issues 1 through 5 above, section 6103(h)(4)(B) and/or (C) applies.

Documents obtained by AA's examiner that pertain to the O partnership's participation in the lease-stripping transactions identified above qualify for use and disclosure under I.R.C. § 6103(h)(4)(B) and/or (C). Conversely, documents obtained by the examiner regarding the O partnership that do not relate to the lease-stripping transactions do not qualify under I.R.C. § 6103(h)(4)(B) and (C) and can only be used or disclosed to the extent that some other exception to I.R.C. § 6103(a) applies.

8. Would it violate I.R.C. § 6103(a) to disclose to the A entities a document that referred to the separate investment that involved F, AA and an A entity?

As with the issues 1 through 5 and 7 above, the key section is section 6103(h)(4)(B) and/or (C), but the analysis for this issue differs because the lease-stripping transactions are not as clearly in focus with this separate investment.

Although A's representative alleges that this call option investment was directly related to the preferred stock arrangements, the mere unsupported assertion of a party's representative is not sufficient to make section 6103(h)(4)(B) or (C) apply. If it were, taxpayers could obtain protected third party return information in discovery merely by asserting that such information is related to a transaction in their proceeding. Although the allegation of A can be considered as one indicia of a transactional relationship, the analysis of the section 6103(h)(4)(B) and (C) issues must undertake more than reliance on this assertion by A's representative.

As F, AA and an A entity entered into the investment, the first statutory requirement of section 6103(h)(4)(B) or (C), that the third tax party information relate to a transactional relationship between the taxpayer and the third party, is met. That leaves the second statutory requirement, that the information directly affects the resolution of an issue in the proceeding. In order for this requirement to be

satisfied, then either: 1) there must be information (other than the mere assertion by A), that this separate investment was in fact, directly related to the lease-stripping transactions[4]; or 2) the resolution of an issue in A's proceeding other than one involving the basis of the preferred stock must be directly affected.[5]

With those aforementioned qualifications in mind, third party return information relating to the investment by F, AA and the A entity qualifies for use and disclosure in A's proceeding under I.R.C. § 6103(h)(4)(B) and (C) to the extent it directly affects the resolution of an issue in A's judicial tax proceeding.

9. Is it permissible for the examiner of A to continue gathering records after the District Court petitions are filed, for use in the litigation, from an examiner assigned to audit one of the parties to the lease-stripping transactions that generated the basis in the preferred stock that was acquired by the A entities?

The A examiner may continue to gather records during the pendency of the District Court case from inside the IRS.

10. If it is permissible for the examiner of A to gather the records identified above, may the records be disclosed to A?

Records obtained by the A examiner that contain third party information may only be disclosed to A to the extent that I.R.C. § 6103(h)(4)(B) and/or (C) apply. Determining the application of I.R.C. § 6103(h)(4)(B) and/or (C) requires understanding the facts concerning the records and how they relate to the relevant transactions. We would expect that the analysis under section 6103(h)(4)(B) or (C) would be comparable to that of the third party records already in the possession of A, but an authoritative opinion cannot be rendered until such records can be identified and described.

11. Must all documents relating to the underlying lease-stripping transactions in the Service's possession be produced in response to a broad discovery request?

Third party tax return information that is protected by section 6103(a) is not subject to production as part of civil discovery unless subject to exception from section

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[4]If directly related to the lease-stripping transactions, then the basis of the preferred stock is affected.

[5]For example, if A improperly understated its liability arising from this separate transaction (and this liability occurred during the tax years at issue), this would directly affect the resolution of an issue in the proceeding.

6103(a) under another provision of the Internal Revenue Code. See Lehrfeld v. Commissioner, 132 F.3d 1463 (D.C. Cir. 1998); Tax Analysts v. Internal Revenue Service, 214 F.3d 179 (D.C. Cir. 2000). Conversely, third party tax return information that qualifies for disclosure under section 6103(h)(4)(B) and/or (C) must be produced in response to a discovery request, unless protected by some other privilege (or if it would identify a confidential informant or seriously impair a civil or criminal tax investigation). Accordingly, the analysis of whether documents relating to the underlying lease-stripping transactions in the Service's possession qualify for disclosure under section 6103(h)(4)(B) and/or (C) would be the same as that already undertaken in the issues discussed above. We do not opine with respect to privileges that may apply.

12. Are the closing agreements relating to S and U, as they relate to the underlying lease-stripping transactions, protected from disclosure in response to a discovery request by the A entities?

As with issue 11 above, third party information must be produced in discovery only to the extent that it qualifies under I.R.C. § 6103(h)(4)(B) and/or (C). It is unlikely that any information in the closing agreements can qualify under I.R.C. § 6103(h)(B) and/or (C) because information in the closing agreements will not directly affect the resolution of an issue in A's proceeding. The issue in the proceeding is the correct tax treatment of the lease-stripping transactions and determination of A's basis in the preferred stock–the issue is not how the Service treated other parties to the transaction. As closing agreements cannot be relied upon by taxpayers other than the taxpayers who are a party, the second statutory requirement of I.R.C. § 6103(h)(4)(B) and/or (C), that the information directly relate to or directly affect the resolution of an issue in the proceeding, will not be met.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please call if you have any further questions.