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Kristin E. Hickman

COMMENTS

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I. INTRODUCTION

The proliferation of multinational corporations continues to shrink the world. Daily, the component divisions and subsidiaries of such corporations shift goods, services, and intangibles among themselves, despite the national borders that separate them. The measurement and taxation of these transactions perpetually challenge the taxing authorities of different nations.[1] Universally, the world recognizes each nation's right to tax the economic activity within its jurisdiction.[2] However, if a corporation has various sub-entities scattered around the globe, how much of that corporation's bottom line can each nation tax? For that matter, when a corporation can shift its income and expenses across borders through these intercom-

* I would like to thank Prof. Charlotte Crane for suggesting this topic and Trey Hickman for his patience and support.

[1] 12 MERTENS LAW OF FED. INCOME TAX *Transfer Pricing: Section 482* § 45I.01 (West 1997) [hereinafter MERTENS].

[2] Pamela L. Kayfetz & Leo B. Helzel, *Transfer Pricing: Achieving Fair National Taxation of International Transactions*, 3 ANN. SURV. INT'L & COMP. L. 193 (1996).

pany transactions, how can each nation determine the true net income from a corporation's activities within that country's jurisdiction? Multinational taxpayers and the world's taxing authorities have been struggling with these questions for decades,[3] but have been unable to agree upon any single, uniform jurisdictional approach.[4] However, the dramatic internationalization of business, accompanied by an exponential increase of the dollar amounts in question, have brought new attention to this issue.[5] The magnitude of the problem has grown so that what was formerly an arcane province of tax gurus attracted popular news media attention and became an issue in the 1992 U.S. presidential election.[6] The Internal Revenue Service and members of Congress have expressed concerns that certain types of intercompany cross-border transactions have resulted in significant lost revenue for the United States.[7] Adding in the Internet's potential future impact, jurisdictional issues have become one of the biggest taxation challenges heading into the next century.[8]

Transfer pricing is the term used to describe the methods by which multinational taxpayers account for transactions among subsidiaries and divisions in different countries.[9] Historically, the world's taxing authorities have worried about multinational corporations using intercompany transactions to shift earnings among subsidiaries to avoid taxation.[10] Similarly, corporations have been concerned about double taxation, that is, paying taxes on the same income to two or more countries.[11] In one 1995 survey, eight out of ten companies identified transfer pricing as the biggest issue facing multinational corporations today.[12]

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[3] Robert L. Palmer, *Toward Unilateral Coherence in Determining Jurisdiction to Tax Income*, 30 HARV. INT'L L.J. 1, 6-7 (1989).

[4] *Id.* at 30, (noting that global interest in international taxation issues began with an increase in international trade during in the 1920's).

[5] Dale W. Wickham & Charles J. Kerester, *Tax Policy Forum: New Directions Needed for Solution of the Transfer Pricing Tax Puzzle*, 5 TAX NOTES INT'L 399, 401 (1992).

[6] *Id.* at 400-01. *See also* Martin A. Sullivan, *Transfer Pricing: Trouble Waiting to Happen?*, 13 TAX NOTES INT'L 93, 93 (1996).

[7] Arthur L. Nims, III, *Tax Court Management of Jumbo Cases: The New Challenge*, 38 FED. B. NEWS & J. 330 (1991). Projections of lost revenue have ranged from $100 million to $10 billion, although Congressional experts have called this latter figure unrealistic. Sullivan, *supra* note 6.

[8] Ernst & Young LLP, *Transfer Pricing: Risk Reduction and Advance Pricing Agreements*, 10 TAX NOTES INT'L 293, 293 (1995).

[9] Kayfetz & Helzel, *supra* note 2, at 194.

[10] Ernst & Young LLP, *supra* note 8, at 299. Of multinational corporations ("MNCs") surveyed, 40% of British MNCs, 44% of German MNCs, 48% of Canadian MNCs, 50% of U.S. MNCs, 56% of Australian MNCs, 70% of Japanese MNCs, and 72% of Dutch MNCs considered transfer pricing to be the most important international tax issue they face.

[11] This is especially the case when the competing jurisdictions do not harmonize their tax rules. Wickham & Kerester, *supra* note 5, at 401.

[12] Ernst & Young LLP, *supra* note 8, at 294.

In the last ten years, the combined efforts of the United States Congress and the Internal Revenue Service (the "IRS") have been a driving force behind the increased attention paid to these issues globally.[13] One of the more interesting mechanisms that has emerged from this effort has been the development of bilateral and multilateral advance pricing agreements ("APAs"). An advance pricing agreement is an arrangement between a taxpayer and the IRS on the best method, within the meaning of Treasury Regulations, for determining arm's length[14] prices for intercompany transactions, and the proper application of that method to the taxpayer's specific facts and circumstances.[15] The IRS is not alone in its use of advance pricing agreements. Several other nations have adopted similar processes,[16] and many advance pricing agreements are negotiated between the taxpayer and two or more taxing authorities.[17] "The premise underlying the APA is that U.S. and foreign jurisdictions cooperate to tax the company's international affairs as one global business."[18] While hailed by many as a step in the right direction toward addressing some disputes,[19] advance pricing agreements are not a panacea for resolving all transfer pricing issues, and are not without controversy themselves.

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[13] *Id.* at 293-94.

[14] An arm's length price is the amount that an unrelated party would have paid in the same circumstances as in the controlled transaction. MERTENS, *supra* note 1, § 45I.26. At the heart of Internal Revenue Code ("IRC") § 482 is the requirement that related taxpayers deal with one another on an arm's length basis. *Id.* at § 45I.27. The arm's length concept is accepted internationally with respect to transfer pricing. Reuven S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, 15 VA. TAX. REV. 89 (1995). The United States has been sharply criticized in recent years for treasury regulations under IRC § 482 that allow the comparable profits method for transfer pricing calculations, viewed as a move away from the arm's length concept. Sven-Olof Lodin, *Is the American Approach Fair? Some Critical Views on the Transfer Pricing Issues*, 1995 INTERTAX 240, 242. However, many corporations view advance pricing agreements as a way around the confusion created by conflicts between different methodologies. *Id.* at 243. *See also* discussion of transfer pricing methodologies, *infra* note 56.

[15] Rev. Proc. 96-53, 1996-2 C.B. 375, § 3.02.

[16] *See, e.g.*, Timothy W. Cox, *Australian Tax Office Releases Draft Ruling on Advance Pricing Agreements*, 9 TAX NOTES INT'L 1279; *Eleven Canadian APAs Completed, Thirty More in Process, Official Says*, BNA INT'L BUS. & FIN. DAILY, Mar. 31, 1997, at d7; Albertina M. Fernandez, *Mexico Issues First Maquiladora APA*, 11 TAX NOTES INT'L 1276 (1995); John Turro, *Netherlands Formalizes APA Procedures*, 9 TAX NOTES INT'L 1531 (1994).

[17] *See, e.g.*, John Turro, *IRS Inks Two Pricing Agreements in Derivative Products Area*, 55 TAX NOTES 725 (1992).

[18] *Id.*

[19] Mike McIntyre, *The Case for Public Disclosure of Advance Rulings on Transfer Pricing Methodologies*, 2 TAX NOTES INT'L 1127 (1990).

At present, the IRS does not publish advance pricing agreements, contending that to do so would violate taxpayer confidentiality.[20] This policy has been controversial since the inception of the program.[21] In 1996, the Bureau of National Affairs ("BNA"), a Washington-based legal publisher, filed suit against the IRS for the disclosure of advance pricing agreements under Internal Revenue Code ("IRC") § 6110[22] and the Freedom of Information Act[23] ("FOIA").[24] Although the IRS recently conceded certain positions in an effort to settle the case,[25] the parties continue to disagree on major issues,[26] and various business interest have filed or requested the right to file amicus briefs urging the judge to reject BNA's motion for summary judgment and the IRS's concession.[27]

BNA argues that advance pricing agreements, as statements of policy and legal interpretation, should be published for the benefit of other taxpayers.[28] Supporters of BNA's position also express concern that a secret body of law is being developed with respect to transfer pricing, and that similarly situated taxpayers may be treated unfairly as a result.[29] However, if BNA's suit is successful, the likely result will be the decline of the advance pricing

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[20] *Letter dated May 29, 1996, from John B. Cummings, Asst. Chief Counsel, [IRS] Disclosure Litigation, to William A. Dobrovir, Esq.*, 96 TAX NOTES TODAY 115, 115-128 (1996) [hereinafter *Letter to William A. Dobrovir, Esq.*].

[21] *See* McIntyre, *supra* note 19, at 1127.

[22] 26 U.S.C.A. § 6110 (West 1997).

[23] 5 U.S.C.A. § 552 (West 1997).

[24] *BNA Complaint Demanding APAs*, 96 TAX NOTES TODAY 42-33 (1996) (publishing BNA's original complaint under IRC § 6110); *IRS Issues Final Denial of Tax Analysts' FOIA Request for APAs*, 12 TAX NOTES INT'L 1929, 1929 (1996) (reporting BNA's amendment to its complaint adding a claim for release of the information under FOIA).

[25] *See IRS Memorandum In Opposition to Plaintiff's Motion for Summary Judgment in BNA v. IRS, Seeking Disclosure of Advance Pricing Agreements*, DAILY TAX REP., Jan. 13, 1999, at L-8. [hereinafter *IRS Memorandum In Opposition to Plaintiff's Motion for Summary Judgment*]

[26] *See, e.g., BNA's Memorandum In Opposition to IRS's Proposed Schedule for Redaction and Release of Advance Pricing Agreements with Proposed Order*, DAILY TAX REP., Feb. 23, 1999, at L-1 [hereinafter *BNA's Memorandum In Opposition to IRS's Proposed Schedule*]; *IRS's Reply to BNA's Opposition to Service's Proposed Schedule for Redaction and Release of APAs in BNA v. IRS*, DAILY TAX REP., Mar. 3, 1999, at L-3 [hereinafter *IRS's Reply to BNA's Opposition*].

[27] *See Motion by Three Companies for Leave to Participate as Amici Curiae in BNA's APA Access Case Against IRS*, DAILY TAX REP., Mar. 1, 1999, at L-5 [hereinafter *Motion by Three Companies for Leave to Participate as Amici Curiae*];. *Motion and Memorandum of Tax Executives Institute Regarding Amicus Curiae Opposition to BNA Motion for Summary Judgment Against IRS*, DAILY TAX REP., Feb. 26, 1999, at L-1 [hereinafter *Motion and Memorandum of Tax Executives Institute Regarding Amicus Curiae Opposition*].

[28] *BNA Complaint Demanding APAs, supra* note 24, at 26-28.

[29] McIntyre, *supra* note 19, at 1128-29.

agreement program altogether,[30] leaving taxpayers back where they started before.[31]

The purpose of this comment is to review the role and function of the advance pricing agreement process, to examine the merits of both sides' arguments in the BNA suit, and to discuss the policy implications should BNA prevail. While advance pricing agreements are not the ultimate solution to transfer pricing disputes and tax jurisdiction issues, they are a dispute resolution tool worth maintaining, at least until Congress or Treasury provides greater guidance in this area. Sufficient legal basis exists for the courts to find against BNA and rule that advance pricing agreements are exempt from publication under IRC § 6103. However, if the courts do not, Congress should step in and make advance pricing agreements exempt for policy reasons.

II. THE ROLE AND FUNCTION OF THE ADVANCE PRICING AGREEMENT PROCESS

A. Transfer Pricing Enforcement Before Advance Pricing Agreements

Compliance in the transfer pricing area has always been problematic.[32] In the late 1980s and early 1990s, the United States government made several controversial attempts to address transfer pricing issues, starting with modifications expanding the scope of IRC § 482 in the Tax Reform Act of 1986.[33] In 1988, the Treasury Department issued a White Paper on Transfer Pricing, calling for major changes in U.S. transfer pricing rules.[34] In 1989 and 1990, Congress amended IRC § 6038A and added IRC § 6038C, expanding the recordkeeping requirements for any U.S. corporation that is 25% foreign-owned, with specific penalties for failure to comply.[35] Also in 1990, Congress added IRC §§ 6662(e) and (h), imposing severe penalties of up to 40% on tax deficiencies resulting from transfer pricing adjustments.[36] Since 1992, Congress has given the IRS additional funding to address trans-

[30] Mitchell Tropin, *APAs: Issuing Redacted Versions of APAs Seen as 'Administrative Nightmare' for IRS*, DAILY TAX REP., Aug. 5, 1996, at G1.

[31] *See infra* Part II.A.

[32] *See, e.g.*, John Turro, *Practitioners Find Harsh Rules in New Transfer Pricing Penalty Regs*, 62 TAX NOTES 806 (1994) (explaining the difficulties experienced with these sort of regulations); Steven C. Wrappe, *Advance Pricing Agreements: The IRS Rediscovers Alternative Dispute Resolution*, 63 TAX NOTES 1343 (1994) (illustrating the problems involved in resolving transfer pricing regulation violations).

[33] *See* Kayfetz & Helzel, *supra* note 2, at 201.

[34] Treasury Dep't, A Study of Intercompany Pricing Under Section 482 of the Code (1988), reprinted in Notice 88-123, 1988-2 C.V. 458. *See also* Ernst & Young LLP, *supra* note 8, at 293.

[35] *See* 26 U.S.C.A. §§ 6038A, 6038C (West 1997). *See also* Wrappe, *supra* note 32, at n.6.

[36] *See* 26 U.S.C.A. §§ 6662(e), (h) (West 1997). *See also* Wrappe, *supra* note 32, at n.6.

fer pricing issues.[37] Following Congress' lead, the Department of the Treasury issued new regulations governing transfer pricing in 1992 and 1993;[38] and the IRS hired additional international examiners and economists and increased the number of audits of foreign controlled corporations.[39]

Despite all of the new efforts, settling transfer pricing disputes within traditional IRS processes remains difficult.[40] Congress and the IRS have steadfastly avoided committing to objective standards for transfer pricing calculations, preferring instead a facts and circumstances approach.[41] Often, even after the IRS completes an audit and issues a deficiency notice, the Commissioner's view of the issues is still evolving.[42] The Tax Court has been completely overwhelmed by the size and complexity of transfer pricing litigation.[43] Yet in several cases, the Tax Court has failed to endorse any particular theory, resulting in even more confusion.[44] Moreover, members of the Tax Court hoped that its 1990 adoption of Rule of Practice and Procedure 124 ("Rule 124"), allowing arbitration of valuation cases, would ease the court's burden.[45] Arbitration under Rule 124 has been used in transfer pricing cases.[46] However, it is not yet clear whether Rule 124 will make a substantive difference in the Tax Court's backlog; and no one believes that Rule 124 will resolve the confusion surrounding transfer pricing generally.[47] The failure of Congress, the Treasury Department, and the IRS to develop coherent and specific rules in this area have further exacerbated this problem.[48]

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[37] Ernst & Young LLP, *supra* note 8, at 294.

[38] Wrappe, *supra* note 32, at n.7.

[39] Wrappe, *supra* note 32, at 1344.

[40] *Id.* at 1347.

[41] *See* Nims, *supra* note 7, at 331.

[42] *Id.* at 333. "Yet, the Commissioner's view of the issues often can still be evolving even after the deficiency notice is sent; his theories might not be fully formulated until he has had an opportunity for some discovery." Nims, *supra* note 7, at 331.

[43] C. David Swenson, *International Tax Developments: Intercompany Pricing Issues*, 314 PLI/TAX 447, 453 (1991). *See, e.g.*, Seagate Technology, Inc. v. Commissioner, 102 T.C. 149 (1994).

[44] Matthew T. Adams, *Advance Pricing Agreements: Rev. Proc. 91-22 – Possible Certainty Under Section 482*, 314 PLI/TAX 49, 59 (1991). *See, e.g.*, Sundstrand v. Commissioner, 96 T.C. 226 (1991) (wherein the court adopted an approach for which neither party had argued).

[45] MERTENS, *supra* note 1, § 45I.06.50. *See also* Wrappe, *supra* note 32.

[46] *See, e.g.*, Wrappe, *supra* note 32, at 1357 (discussing the outcome of the Apple Computer case, resolved through arbitration under Rule 124).

[47] *Id.*

[48] Wickham & Kerester, *supra* note 5, at 405 (noting the Tax Court's comments about shifting IRS positions in Sundstrand Corp. v. Commissioner, 96 T.C. 226 (1991)).

B. The Advance Pricing Agreement Program As An Alternative

In 1990, looking for a solution to transfer pricing enforcement difficulties, the IRS developed the advance pricing agreement program as an alternative dispute resolution tool.[49] "The APA process is designed to be a flexible problem-solving process, based on cooperative and principled negotiations between taxpayers and the [IRS]."[50] In addition to taxpayer cooperation, the IRS intended the program to encourage its own personnel from various departments "to find common grounds to work together to achieve collective goals."[51] Initially, suspicious tax executives of multinational corporations had little interest in the program, calling the process too cumbersome and time-consuming.[52] However, the severity of the potential § 6038 penalties, the ease with which they can be triggered, and the possibility of audits and litigation have lead many foreign-based and U.S.-based multinational corporations to seek advance pricing agreements. After Matsushita Electric Industrial Co. of Japan successfully negotiated an advance pricing agreement with the IRS, several other Japanese firms entered the program as well.[53] The program has grown in popularity with multinational corporations seeking to minimize risk.[54]

Following established guidelines[55], the taxpayer negotiates with the IRS to establish agreed-upon transfer pricing methodology[56] prior to the filing of the corporation's tax return. The advance pricing agreement proc-

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[49] *See* Rev. Proc. 91-22, 1991-1 C.B. 526. Alternative dispute resolution methods are used by government entities to settle disputes without litigation. Wrappe, *supra* note 32. "In response to judicial delays, spiraling litigation costs, and generally unsatisfactory results for all involved parties, a growing number of federal agencies have begun to employ ADR techniques." *Id.* The U.S. government has found that ADRs promote settlements fair both to government concerns and to other parties. *Id.* ADRs also curtail the government resources required to resolve disputes. *Id.*

[50] Rev. Proc. 96-53, 1996-2 C.B. 375-76, § 3.01.

[51] Cym H. Lowell & Marc M. Levey, *Critical APA Issues Explained and Updated in Rev. Proc. 96-53*, 8 J. INT'L TAX'N 74, 76 (1997).

[52] *Large Companies Reconsidering Opposition to APAs, Practitioners Say*, DAILY TAX REP., Sept. 27, 1993, at J1.

[53] *Id.*

[54] Ernst & Young LLP, *supra* note 8, at 293.

[55] *See* Rev. Proc. 96-53, 1996-2 C.B. 376.

[56] Transfer pricing methodologies have been a source of debate for several years, both in the United States and among its trading partners. For example, United States and Japanese tax laws currently utilize different methodologies. Akira Akamatsu, *Japanese Competent Authority Discusses U.S. APA Procedure*, 14 TAX NOTES INT'L 1109, 1110 (1997). No clear consensus has emerged as to what is the best method. Professor Avi-Yonah chronicles the various methods used globally as well as the history of U.S. method regulations. Avi-Yonah, *supra* note 14. He notes that one of the problems historically has been that no one method is especially accurate for all taxpayers, or even for all transactions for a single taxpayer. *Id.* at 141. Professor Avi-Yonah sees advance pricing agreements as a potential solution for this problem. *Id.* at 154.

ess begins with one or more prefiling conferences where the taxpayer and the IRS discuss what information the IRS would require to reach an agreement.[57] Then, if the taxpayer elects to pursue an advance pricing agreement, it must submit a formal request including proposed transfer pricing methodologies and a user fee.[58] Each proposed transfer pricing methodology must be supported by relevant pricing data from comparable uncontrolled transactions or other similar dealings.[59] Furthermore, each proposed transfer pricing methodology must be demonstrated by its application to the applicant's tax and financial data for the past three years, if available, or else projected or hypothetical data.[60] The proposal must also include detailed information about the corporation's history, organizational structure and capitalization, and financial arrangements; income tax returns; research, development, production, and technology acquisition cost detail; pricing, distribution, and licensing agreements; marketing studies; and a slew of other internal reports, documentation, and analyses.[61] An IRS team will analyze the data provided by the taxpayer, along with other relevant information.[62] Altogether, once the taxpayer has submitted a formal request, the evaluation and negotiation process is expected to take six to nine months,[63] although it may take longer.[64] As a result of these negotiations, the taxpayer and the IRS may agree upon a transfer pricing methodology and enter into an advance pricing agreement.[65] Although an advance pricing agreement can cover all of a corporation's operations, often they are focused more narrowly on a particular market or product niche.[66]

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[57] Rev. Proc. 96-53, 1996-2 C.B. 376, § 4.01.

[58] Rev. Proc. 96-53, 1996-2 C.B. 376-77, §§ 5.01(4), 5.02. The user fee for each separate request is $5,000 for taxpayers with gross income less than $100 million, $15,000 for taxpayers with gross income between $100 million and $1 billion, and $25,000 for taxpayers with gross income exceeding $1 billion. Requests involving more than one foreign jurisdiction are deemed multiple bilateral requests. In such cases, the user fee for the first request is determined as above, and the fee for each subsequent bilateral request will be no more than $7,500. Rev. Proc. 96-53, 1996-2 C.B. 380, § 5.14(10).

[59] Rev. Proc. 96-53, 1996-2 C.B. 376-77, §§ 3.03, 5.02.

[60] Rev. Proc. 96-53, 1996-2 C.B. 377, § 5.02.

[61] *See* Rev. Proc. 96-53, 1996-2 C.B. 377-78 §§ 5.03(4)-5.08. The items listed above are only a few of those included in the detailed listing of required documentation stretching over several pages in this Revenue Procedure. However, they are representative of the proprietary nature of the information that must be disclosed by a taxpayer to the IRS during the advance pricing agreement process.

[62] Wrappe, *supra* note 32.

[63] *Id.*

[64] Negotiations for the advance pricing agreements obtained by Sumitomo Bank Capital Markets, Inc., and Barclays Bank PLC took approximately eighteen months. Turro, *supra* note 17, at 725.

[65] Wrappe, *supra* note 32.

[66] *Large Companies Reconsidering Opposition to APAs, Practitioners Say*, *supra* note 52, at J1.

Because of the sensitivity of the information that must be disclosed to the IRS, participants in the advance pricing agreement program have expressed great concern for the confidentiality of that data.[67] For now, given the success of the program, many have concluded that the benefits of advance pricing agreements outweigh those concerns. But publication of advance pricing agreements could tilt the scale the other way.

C. The International Perspective

Transfer pricing, by its nature, is not just a problem in the United States; everything Congress and the IRS do in this area influences the actions of other taxing authorities.[68] Historically, the United States has been the leader in transfer pricing issues, setting the standard for other nations to follow.[69] In response to the increased attention paid to transfer pricing in the U.S., other countries have followed suit.[70] "If there is a global tax war today — and many believe there is — the declaration of war occurred in 1986 when the U.S. revised its statutory transfer pricing rules."[71] Canada, Australia, the United Kingdom, and Japan have all passed new legislation, revised administrative rules, and expanded their own enforcement efforts in this area as well.[72] Several countries have developed their own advance pricing agreement processes, including Australia, Canada, the Netherlands, Japan, Germany, and the United Kingdom.[73]

The most exciting trend has been the proliferation of bilateral and multilateral advance pricing agreements. Over the last 50 years, an extensive network of bilateral tax treaties between various nations has developed, supplemented by multinational guidelines established by organizations like the Organisation for Economic Cooperation and Development (the "OECD").[74] These treaties generally contain so-called "mutual agreement

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[67] Ernst & Young LLP, *supra* note 8, at 294.

[68] Palmer, *supra* note 3, at 20; *see also* Lodin, *supra* note 14, at 240.

[69] *See* Lodin, *supra* note 14, at 240 (discussing the influence historically of United States transfer pricing regulations on the Organisation for Economic Co-operation and Development ("OECD") and European nations); Joseph A. Guttentag & Toshio Miyatake, *Transfer Pricing: U.S. and Japanese Views*, 8 TAX NOTES INT'L 375 (1994).

[70] Ernst & Young LLP, *supra* note 8, at 293.

[71] *Id.*

[72] *Id.* at 294. Note, however, that Japan's preconfirmation system, similar to the U.S. advance pricing agreement program, was introduced in 1987, four years before the U.S. program was established. Akamatsu, *supra* note 56. *But see* Akiri Akamatsu, *Japanese NTA Announces Stepped-Up Enforcement of Transfer Pricing Regulations*, 7 TAX NOTES INT'L 1094 (1993) ("Japan's National Tax Administration (NTA) has announced a policy of even more thorough enforcement of the country's transfer pricing regulations....The present policy has been viewed as 'retaliatory taxation' vis-a-vis the new U.S. temporary regulations.")

[73] Ernst & Young LLP, *supra* note 8, at 293.

[74] *See generally* T. Modibo Ocran, *Double Taxation Treaties and Transnational Investment: A Comparative Study*, 2 TRANSNAT'L LAW 131 (1989).

procedure" provisions facilitating cooperation between the parties to resolve double taxation claims of taxpayers.[75] The purpose of such provisions is to allow taxpayers to request assistance from tax authorities to relieve double taxation.[76] Utilizing these mutual agreement procedures, multinational corporations have worked successfully with the taxing authorities of two or more countries simultaneously, developing transfer pricing methodologies that are satisfactory to all the parties involved.[77] Various taxing authorities have joined together to encourage this trend. For example, in October 1994, the taxing authorities of Canada, Australia, Japan, and the United States reached agreements on common procedures for bilateral advance pricing agreements, including simultaneous submission of the same information by taxpayers to all the authorities involved.[78] The taxing authorities of Mexico, Germany, and The Netherlands have also developed advance pricing agreement procedures.[79]

Involving other taxing authorities in the advance pricing agreement process makes sense because the transactions under scrutiny involve more than one jurisdiction. With unilateral advance pricing agreements in which the other side of the transaction involves a treaty partner, the U.S. will attempt to obtain a correlative adjustment from the treaty country's taxing authority.[80] However, just because the IRS agrees to a particular transfer pricing methodology does not guarantee that the taxing authority on the other side of the transaction will adjust its assessment accordingly.[81] Therefore, bilateral and multilateral advance pricing agreements have the advan-

[75] *See, e.g.*, Convention Between the United States of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, May 4, 1954, U.S.-Japan, art. XVIII; Convention Between the United States of America and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, Dec. 18, 1992, U.S.-Neth., art. 29, Senate Treaty Doc. 6, 103d Cong., 1st Sess. *See also* Robert T. Cole & Steven A. Musher, *Introduction to Tax Treaties and Competent Authority Mechanism*, C694 ALI-ABA 93, 108 (1991) (discussing mutual agreement procedure provisions generally).

[76] Rev. Proc. 96-13, 1996-1 C.B. 616, § 2.01.

[77] *See, e.g.*, Simon Phillipson, *Australia Enters Multilateral Advance Pricing Agreement*, 2 J. INT'L TAX'N 116 (July/Aug. 1991) (discussing agreement involving the Australian Taxation Office, the United States Internal Revenue Service, and Apple Computer Australia Pty Ltd.); Sunghak Andrew Baik & Michael Patton, *Japan Steps Up Transfer Pricing Enforcement: Joins the APA Fray*, 11 TAX NOTES INT'L 1271, 1273 (1995) (discussing various agreements to which the Japanese National Tax Administration has been a party, including an agreement with the United States Internal Revenue Service and Matsushita Electric Industrial Co.); Turro, *supra* note 17 (discussing agreements involving the United Kingdom's Inland Revenue, the IRS, and both Barclay's Bank PLC and Sumitomo Bank Capital Markets, Inc.).

[78] Blake Murray & Andrew Kingissepp, *Advance Pricing Agreements: Pros and Cons*, 5 CANADIAN CURRENT TAX 26 (1994).

[79] Ernst & Young LLP, *supra* note 8, at 294.

[80] Lowell & Levey, *supra* note 51, at 77.

[81] Akamatsu, *supra* note 72, at 1110.

tage of eliminating double taxation while also eliminating the risk of audits, litigation, and penalties.[82] Recognizing the benefits of bilateral and multilateral advance pricing agreements, the IRS has adopted policies discouraging unilateral advance pricing agreements.[83] For example, Revenue Procedure 96-53 states that the IRS may provide information obtained through the advance pricing agreement process to the tax authorities of treaty partners even if a unilateral agreement is sought.[84]

Advance pricing agreements are not suitable for all multinational taxpayers. Because the process is expensive, participation in the program has been limited primarily to large multinationals, leaving smaller corporations to struggle with more traditional approaches.[85] As taxpayers and the IRS gain more experience and the process matures, advance pricing agreements should become less costly.[86] Nevertheless, advance pricing agreements offer only a stop-gap solution for taxpayers seeking predictability in the absence of clearly defined policies and guidelines from the world's taxing authorities.[87]

III. BNA v. IRS

On February 27, 1996, BNA filed suit in United States. District Court for the District of Columbia requesting that advance pricing agreements be released under IRC § 6110 as written determinations.[88] On April 3, 1996, BNA amended its complaint to include a similar request under FOIA subsection (a)(2).[89] BNA filed the lawsuit after their administrative request for public release was denied by the IRS on grounds of taxpayer confidentiality under IRC § 6103.[90]

A. The General Rule of Publication and Confidentiality

FOIA subsection (a)(2) generally requires that statements of policy and interpretations of law which have been adopted by a federal agency must be

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[82] *See id.* at 1110; McIntyre, *supra* note 19, at 1128; Murray & Kingissepp, *supra* note 78, at 26.

[83] Akamatsu, *supra* note 72, at 1110.

[84] Rev. Proc. 96-53, 1996-2 C.B. 381, § 7. This position is consistent with the mutual agreement procedures in the various bilateral tax treaties discussed in the text accompanying notes 75 and 76, *supra*.

[85] *Large Companies Reconsidering Opposition to APAs, Practitioners Say*, *supra* note 52, at J1. Some advance pricing agreements have cost more than $2 million in attorney and economist fees. *Id.*

[86] *Id.*

[87] Wickham & Kerester, *supra* note 5, at 401.

[88] *IRS Issues Final Denial of Tax Analysts's FOIA Request for APAs*, *supra* note 24.

[89] *Id.*

[90] *Id.*

made available for public inspection and copying.[91] FOIA subsection (b)(3) excludes from this general rule matters specifically exempted from disclosure by other statute,[92] but "'any reasonably segregable portion of a record' must be produced after deletion of the exempt portion."[93]

IRC § 6103 governs confidentiality and disclosure, preventing officers and employees from revealing "returns" or "return information."[94] It is well accepted at law that IRC § 6103 is the type of statute contemplated by FOIA § 552(b)(3).[95] Thus, FOIA cannot be used to compel disclosure of any information exempted by IRC § 6103, including returns and return information.[96] The courts have interpreted § 6103 broadly so as to include

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[91] 5 U.S.C.A. § 552 (a)(2) (West 1997) ("Each agency, in accordance with published rules, shall make available for public inspection and copying ... (B) those statements of policy and interpretations which have been adopted by the agency and are not published in the Federal Register.")

[92] 5 U.S.C.A. § 552 (b)(3) (West 1997)

> This section does not apply to matters that are ... (3) specifically exempted from disclosure by statute (other than section 552b of this title), provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld.

[93] Tax Analysts v. Internal Revenue Service, 117 F.3d 607, 611 (D.C. Cir. 1997) (*quoting* 5 U.S.C. § 552(b)).

[94] 26 U.S.C.A. § 6103 (West 1997). This provision contains extensive definitions of both "return" and "return information." Only the definition of the latter is relevant to the BNA case:

> § 6103(b)(2) Return information. – The term "return information" means –
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> (A) 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, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense, and
>
> (B) any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under 6110, but such term does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. Nothing in the preceding sentence, or in any other provision of law, shall be construed to require the disclosure of standards used or to be used for the selection of returns for examination, or data used or to be used for determining such standards, if the Secretary determines that such disclosure will seriously impair assessment, collection, or enforcement under the internal revenue laws.

[95] Church of Scientology of California v. Internal Revenue Service, 484 U.S. 9, 14-15 (1987). *See also* Tax Analysts, 117 F.3d at 611; Aronson v. Internal Revenue Service, 973 F.2d 962 (1st Cir. 1992); Linsteadt v. Internal Revenue Service, 729 F.2d 998, 1000 (5th Cir. 1984); Fruehauf Corp. v. IRS, 566 F.2d 574, 578 (6th Cir. 1977).

[96] *See* Church of Scientology of California, 484 U.S. at 18.

virtually all data collected by the IRS with respect to a taxpayer's tax liability.[97]

As an exception to this general rule, IRC § 6103(b)(2),[98] known as the Haskell Amendment,[99] expressly excludes from the definition of "return information" "data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer."[100] Congress included the Haskell Amendment language to allow the IRS to publish statistical studies and compilations of data that do not identify individual taxpayers.[101] Like the rest of IRC § 6103, the courts have interpreted the Haskell Amendment narrowly, with great deference to taxpayer confidentiality.[102] "[W]ithout clear taxpayer understanding that the government takes the strongest precautions to keep tax information confidential, taxpayers' confidence in the federal tax system might erode, with harmful consequences for a tax system that depends heavily on voluntary compliance."[103] In *Church of Scientology*, the Supreme Court held that merely removing the taxpayer's name and other identifying data is not enough to remove a document from the "return information" classification.[104] The Supreme Court's *Church of Scientology* interpretation of the Haskell Amendment has been taken to mean that the IRC § 6103(b)(2) exception is strictly limited to statistical studies and other composite products.[105] However, more recently, the United States Court of Appeals for the District of Columbia Circuit has held that the legal analyses sections contained in field service advice memoranda fall within the Haskell Amendment's exception and are not "return information," even though they may pertain to an individual taxpayer.[106]

Because merely deleting identifying data is inadequate to make return information discloseable under § 6103, the IRS has no obligation under FOIA to undertake a more detailed redaction to render it so.[107] However, at the same time that Congress passed IRC § 6103, however, it also enacted IRC § 6110, requiring that all letter rulings, other written determinations,

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[97] J. Hudson Duffalo, *The Buttoned Lip: The Controversy Surrounding the Disclosure of Tax Return Information*, 53 ALB. L. REV. 937, 955 (1989).

[98] 26 U.S.C.A. § 6103(b)(2) (West 1997).

[99] Church of Scientology of California, 484 U.S. at 12.

[100] 26 U.S.C.A. § 6103(b)(2) (West 1997).

[101] Church of Scientology of California, 484 U.S. at 16.

[102] *Id. See also* Aronson v. Internal Revenue Service, 973 F.2d 962 (1st Cir. 1992); King v. IRS, 688 F.2d 488 (7th Cir. 1982); Currie v. IRS, 704 F.2d 523 (11th Cir. 1983).

[103] Aronson, 973 F.2d at 966.

[104] Church of Scientology of California, 484 U.S. at 18.

[105] *Tax Management Portfolios No. 632 Obtaining Information from the Government – Disclosure Statutes and Discovery*, 632 TM II.B.3.c.(5) (1998) [hereinafter *Tax Management Portfolios No. 632*].

[106] Tax Analysts v. Internal Revenue Service, 117 F.3d 607, 615 (D.C. Cir. 1987).

[107] Church of Scientology of California, 484 U.S. at 14.

and related background file documents be made available to the public.[108] The intent of Congress in passing IRC § 6110 was to provide the public access to certain IRS documents without following the FOIA procedures.[109] In the past twenty-five years, several cases have been decided with respect to IRC § 6110 requiring the IRS to make available various documents in redacted form for public use: private letter rulings, technical advice memoranda, related correspondence with taxpayers, and index-digest card summaries of rulings;[110] general counsel's memoranda, technical memoranda, and actions on decisions;[111] and field service advice memoranda.[112] Although these documents do not have precedential value, they provide valuable insight into how the Treasury Department and IRS interpret the law.[113] Documents covered by IRC § 6110 must be requested under that section and cannot be obtained through FOIA because they are confidential and non-discloseable under § 6103.[114]

B. BNA's Arguments for Publishing Advance Pricing Agreements

In its original complaint, BNA alleges that advance pricing agreements are "written determinations" under § 6110.[115] Accordingly, BNA argues that advance pricing agreements, as statements of policy and legal interpretation, should be published for the benefit of other taxpayers.

> Advance Pricing Agreements memorialize in writing determinations by the [Internal Revenue Service] to adopt particular transfer pricing methodologies to assist in the calculation of tax liabilities. Advance

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[108] 26 U.S.C.A. § 6110(a) (West 1997)

> (a) General rule. – Except as otherwise provided in this section, the text of any written determination and any background file document relating to such written determination shall be open to public inspection at such place as the Secretary may by regulations prescribe.
>
> ....
>
> (b)(1) Written determination. – The term "written determination" means a ruling, determination letter, or technical advice memorandum.
>
> (b)(2) Background file document. – The term "background file document" with respect to a written determination includes the request for that written determination, any written material submitted in support of the request, and any communication (written or otherwise) between the Internal Revenue Service and persons outside the Internal Revenue Service in connection with such written determination....

[109] Fruehauf Corp. v. Internal Revenue Service, 566 F.2d 574, 577 (6th Cir. 1977).

[110] Tax Analysts and Advocates v. Internal Revenue Service, 505 F.2d 350, 352-53 (D.C. Cir. 1974).

[111] Taxation with Representation Fund v. Internal Revenue Service, 485 F. Supp. 263, 266 (D.C.Cir. 1980).

[112] Tax Analysts v. Internal Revenue Service, 117 F.3d 607, 615 (D.C. Cir. 1987).

[113] *Tax Management Portfolios No. 632*, *supra* note 105, at II.C.1.

[114] Grenier v. U.S. Internal Revenue Service, 449 F. Supp. 834, 840-41 (D. Md. 1978); Conway v. United States Internal Revenue Service, 447 F. Supp. 1128, 1132 (D.C. Cir. 1978).

[115] *BNA Complaint Demanding APAs*, *supra* note 24, at 26-28.

> Pricing Agreements memorialize transfer pricing methodologies not specified in IRS regulations but still acknowledged by the IRS as achieving an arm's length result. Public access to Advance Pricing Agreements between the IRS and taxpayers would be useful to numerous other taxpayers.[116]

BNA later amended its complaint to add a claim under FOIA subsection (a)(2).

C. The IRS Position Against Publishing Advance Pricing Agreements

The IRS defends its position on several grounds. As expected, the IRS contends that advance pricing agreements and related requested background file documents are "return information" under IRC § 6103, and thus exempt from disclosure under FOIA § 552(b)(3).[117] This line of argument follows the same path as the case law concerning other IRS documents.[118] But the IRS also brings up some new arguments unique to advance pricing agreements.

The IRS argues that advance pricing agreements satisfy other FOIA exemption provisions.[119] First, the IRS maintains that disclosure is exempt under FOIA § 552(b)(3) because of the secrecy clauses of income tax treaties and conventions.[120]

> Although a treaty is not a 'statute,' under Article VI of the United States Constitution, self-executing treaties, such as tax treaties, are placed on an equal footing with federal statutes. . . . Thus, the secrecy clauses require that exchanged information be withheld from the public in such a manner as to leave no discretion on the issue.[121]

Additionally, the IRS points to FOIA § 552(b)(4) requiring the withholding of matters that are "trade secrets and commercial or financial information obtained from a person and privileged or confidential" because "disclosure would be likely . . . to cause substantial harm to the competitive position of the person from whom the information was obtained."[122] The IRS points out that the types of information submitted by taxpayers through the advance pricing agreement process are considered extremely sensitive

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[116] *Id.* at 13-15.

[117] *Letter to William A. Dobrovir, Esq., supra* note 20, *quoting* the IRC § 6103(b)(2)(A) definition of "return information": "APAs and the withheld 'background file documents' are 'data, received by, [or] recorded by . . . the Secretary with respect to . . . the determination of the existence, or possible existence, of liability . . .' of a particular taxpayer."

[118] *See, e.g.*, Tax Analysts v. Internal Revenue Service, 117 F.3d 607, 611 (D.C. Cir. 1987)

[119] *Letter to William A. Dobrovir, Esq., supra* note 20.

[120] *Id.*

[121] *Id.*

[122] *Id.* (*citing* Critical Mass Energy Project v. NRC, 975 F.2d 871, 878 (D.C. Cir. 1992) (en banc)).

by the taxpayers involved.[123] Finally, the IRS makes other FOIA claims of deliberative process privilege and attorney-client privilege.[124]

D. Analysis of the Merits

In the present case, the first question will be whether advance pricing agreements constitute "return information" under § 6103 and are therefore partially exempt from publication under FOIA. With respect to BNA's FOIA claim, IRC § 6103 is well established at law as a FOIA subsection (b)(3) exception to subsection (a)(2).[125] Given the narrow interpretation of the Haskell Amendment by the Supreme Court,[126] it seems unlikely that advance pricing agreements will meet that exception. To the extent that advance pricing agreements contain segregable legal analysis sections applicable to many taxpayers, the recent *Tax Analysts* opinion supports a holding that those portions would be accessible through FOIA under the Haskell Amendment exception. However, the transfer pricing methodology analysis of interest to other taxpayers involves the weighing of the requesting taxpayer's individual factors, the very data which is most confidential and identifiable.

The better case for publishing advance pricing agreements falls under BNA's IRC § 6110 claim that the agreements are written determinations. However, a comparison of advance pricing agreements with other IRS documents which fall under IRC § 6110 demonstrates that they are distinguishable.

Private letter rulings are one type of IRS document that must be published under IRC § 6110.[127] Similar to advance pricing agreements, private letter rulings are issued by the IRS at the request of individual taxpayers seeking guidance in advance of a contemplated transaction.[128] Private letter rulings typically include a short summary of the facts and circumstances of the transaction, followed by a recitation and analysis of the relevant law, and then a conclusion applying the law to the facts. A private letter ruling is only binding on the individual taxpayer making the request, and does not require the taxpayer to undertake the proposed transaction should the IRS give an adverse ruling.[129] The Court of Appeals for the D.C. Circuit found,

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[123] *Id.* (*citing* Ernst & Young LLP, *supra* note 8). *See also* Wrappe, *supra* note 32.

[124] *Letter to William A. Dobrovir, Esq.*, *supra* note 20. The IRS has frequently made these claims in other cases, with little success. *See, e.g.*, Tax Analysts v. Internal Revenue Service, 117 F.3d 607, 616-20 (D.C. Cir. 1987). Accordingly, these claims seem largely pro forma and unlikely to succeed here, either.

[125] *See* discussion *supra* part II.A.

[126] *Id.*

[127] Tax Analysts and Advocates v. Internal Revenue Service, 505 F.2d 350, 352-53 (D.C. Cir. 1974).

[128] *Id.*

[129] *Id.*

therefore, that private letter rulings are not return information under IRC § 6103, but instead are documents generated by the IRS.[130] Accordingly, private letter rulings are publishable once the taxpayer's confidential information has been deleted.[131]

In a recent analogous case, the parties asserted claims concerning field service advice memoranda similar to those made by BNA with respect to advance pricing agreements.[132] Field service advice memoranda are used by the IRS to advise its agents on matters of law.[133] IRS field personnel request legal guidance from the Office of Chief Counsel with respect to a specific taxpayer situation.[134] As with private letter rulings, field service advice memoranda contain a segregable legal analysis section. The Court found, among other things, that the legal analysis portion of field service advice memoranda did not qualify as "return information" under IRC § 6103, and thus was not exempt from publication under FOIA § 552(b)(3).[135]

Private letter rulings and field service advice memoranda are distinguishable from advance pricing agreements, however. First, private letter rulings and field service advice memoranda are one-sided issuances of opinion from the IRS: The taxpayer or field agent requests a legal conclusion for a given set of facts, and the IRS responds with its answer. In contrast, advance pricing agreements involve two-party negotiation toward a compromise between the taxpayer and the IRS. Additionally, both private letter rulings and field service advice memoranda generally address only the interpretation of the law with respect to a discrete set of facts and circumstances. In contrast, because Congress, the Treasury Department, and the IRS have been unwilling to commit to a particular transfer pricing methodology, advance pricing agreements focus primarily on analysis of the facts and circumstances themselves. In other words, the insights to be gained from published advance pricing agreements rest in the facts and circumstances themselves, and not in any discrete and segregable section of legal analysis.

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[130] *Id.*

[131] *Id.*

[132] Tax Analysts v. Internal Revenue Service, 117 F.3d 607 (D.C. Cir. 1987).

[133] *Id.* at 608.

[134] *Id.*

> Each FSA includes a statement of issues, a conclusions section, a statement of facts, and a legal analysis section. The staff preparing an FSA are instructed that the conclusions section should recommend a position on each issue and state 'any limitations or conditions to which a conclusion may be subject.' The style of the analysis section 'should be exploratory and descriptive so that the strengths and weaknesses of a case are presented and developed candidly, directing attention to the authorities against the conclusions arrived at as well as those which support them.'
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> *Id.* (*citing* the Chief Counsel Directives Manual (35)(19)44 (1992)) (footnote omitted).

[135] *Id.* at 616.

Moreover, even under § 6110, identifying details must be deleted.[136] Identifying details include "information that would permit a person generally knowledgeable with respect to the appropriate community to identify any person."[137] The "appropriate community" has been defined as "that group of persons who would be able to associate a particular person with a category of transactions of which one is described in the written determination or background file document."[138] Presumably, given the kind of factual information upon which transfer pricing methodologies are based, the taxpayer's competitors would be able to identify the taxpayer involved by looking at the advance pricing agreement unless such information was redacted as well. By the time the IRS deleted the exempt information so as to meet the requirements of §§ 6103 and 6110, it is questionable whether enough information would be left to provide guidance to anyone.

Advance pricing agreements are not the only such documents not published. Rule 124 arbitration reports are submitted to the Tax Court, and thus become public records.[139] However, since these reports contain only bottom line figures, the underlying data is kept out of the public domain.[140] Similarly, closing agreements, administrative settlements reached by the IRS and taxpayers as part of the audit process, are not published, either.[141] Like advance pricing agreements, closing agreements are negotiated between the taxpayer and the IRS. The arguments made by BNA with respect to advance pricing agreements could similarly be made with respect to the Rule 124 arbitration reports and closing agreements, yet these documents are considered protected. Ultimately, advance pricing agreements are sufficiently distinguishable from field service advice memoranda, private letter rulings, and other IRS determinations that have to be published, so that they fall within the scope of § 6103, and outside the scope of § 6110, and therefore should not be published.

E. Recent Developments

In a brief filed in January 1999 opposing BNA's request for summary judgment, the IRS conceded that APAs are written determinations for purposes of § 6110.[142] Some tax practitioners expressed surprise at the IRS's decision to change its longstanding position on the issue suggesting that

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[136] 26 U.S.C.A. § 6110(c)(1) (West 1997).

[137] *See* 29 C.F.R. § 301.6110-6.

[138] *Tax Management Portfolios No. 632, supra* note 105, at II.C.3.a.

[139] Carlton M. Smith, *Innovative Settlement Techniques Can Reduce Litigation Costs*, 78 J. TAX'N 76, 78 (1993).

[140] *Id.*

[141] *See* S. Rep. No. 94-938, pt. 2 at 307 (1976); H.R. Rep. No. 94-658, pt.2, at 316 (1976).

[142] *See IRS Memorandum In Opposition to Plaintiff's Motion for Summary Judgment, supra* note 25, at L-8.

many of the agency's arguments had merit.[143] The IRS's concession will permit the publication of redacted APAs.[144] However, the IRS has not abandoned its position that much of the information included in the APAs is protected from disclosure by § 6103.[145] Additionally, the IRS continues to claim that portions of the APAs are protected as trade secrets, and that parts of bilateral and multilateral APAs are protected by tax treaty secrecy provisions or are protected by trade secrets.[146] Meanwhile, BNA and the IRS continue to haggle over the terms for redacting and releasing the APAs.[147]

The judge in the case, United States Magistrate Judge John M. Facciola, has not yet ruled on BNA's summary judgment motion, although he has allowed BNA to propose a schedule for redaction and release of APAs.[148] A non-profit organization representing business interests, the Tax Executives Institute Inc., has filed an amicus brief asking the court to reject the IRS's concession and rule that APAs are tax return information under § 6103.[149] Finally, three anonymous companies, concerned about the implications of the IRS's concession with respect to their APAs, have requested that the court permit them to participate as amici curia as well.[150]

IV. POLICY ARGUMENTS FOR AND AGAINST PUBLISHING ADVANCE PRICING AGREEMENTS

Even if the courts decide that advance pricing agreements should be published under current law, Congress can change the Internal Revenue Code to specifically exempt them from publication. When Congress adopted the confidentiality policy of § 6103, it excepted therein written determinations to allow the IRS to provide general guidance to taxpayers. If the BNA court moves the pendulum too far away from confidentiality, Congress can and should step in to exempt advance pricing agreements from publication.

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[143] *See IRS Agrees to Make Redacted APAs Public, Abandons Position in Long-Standing Lawsuit*, DAILY TAX REP., Jan. 12, 1999, at GG-1.

[144] *See IRS Memorandum In Opposition to Plaintiff's Motion for Summary Judgment*, *supra* note 25, at L-8. ("[D]efendants submit that as a result of their concession regarding the application of Sec. 6110 to APAs, defendants have agreed to make the APAs open and available for public inspection and copying in accordance with Sec. 6110.").

[145] *See id.*

[146] *See id.*

[147] *See IRS's Reply to BNA's Opposition*, *supra* note 26, at L-3; *BNA's Memorandum In Opposition to IRS's Proposed Schedule*, *supra* note 26, at L-1.

[148] *See Judge Allows BNA to Propose Schedule for IRS to Make APAs Publicly Available*, DAILY TAX REP., Feb. 11, 1999, at G-7.

[149] *See Motion and Memorandum of Tax Executives Institute Regarding Amicus Curiae Opposition*, *supra* note 27, at L-1.

[150] *See Motion by Three Companies for Leave to Participate as Amici Curiae*, *supra* note 27, at L-5.

A. Implications for Multilateral Corporations/APA Program

Proponents maintain that publication of advance pricing agreements is important to ensure fair application of the tax laws to similarly situated taxpayers by the IRS.[151] Because advance pricing agreements are not published, the IRS has been accused of cutting secret "deals" with individual taxpayers that are not subject to any legal standard or review.[152] Critics have expressed grave concerns about the creation of a secret body of law.[153] Making arguments of the "sunlight is the best disinfectant" variety, these parties seem to be appealing to the public's suspicion of the integrity of the IRS.

Publication supporters claim that such information would provide indispensable guidance to taxpayers in their efforts to properly calculate and pay taxes.[154] Advance pricing agreements are time-consuming and expensive to obtain. The argument is that publishing advance pricing agreements would level the playing field for smaller multinational corporations that otherwise would not be able to afford the process.

Although some claim that democratic principles demand the publishing of advance pricing agreements, this is a false argument. Despite its flaws, the IRS is in fact comparatively open when contrasted with the tax authorities of other democratic nations.[155] Nonetheless, as a matter of policy, Con-

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[151] Peter J. Meadows & William A. Dobrovir, *Who Killed Guidance?*, 96 TAX NOTES TODAY 201, 245 (1996).

[152] Avi-Yonah, *supra* note 14, at 155.

[153] McIntyre, *supra* note 19, at 1128-29.

[154] *Id.* at 1129.

[155] Many nations have financial disclosure requirements under SEC-type regulations. Richard D. Pomp, *The Disclosure of State Corporate Income Tax Data: Turning the Clock Back to the Future*, 22 CAP. U. L. REV. 373, n. 165 (1993). The Japanese government publishes lists of companies that pay the largest amounts of taxes. *Id.* Corporate tax liabilities are public record in Sweden and Norway as well. *Id.* However, these disclosure policies are not necessarily indicative of openness. For example, the Japanese National Tax Administration (the "NTA") publishes nonbinding circulars, internally generated instructions to tax officials interpreting the law, at its own discretion; Japan has no corollary to the Freedom of Information Act, and the NTA is under no obligation by law to publish any of its interpretations. *See* Institute for International Trade Law, THE STATE OF TAXPAYERS' RIGHTS IN JAPAN: A SURVEY OF THE LEGAL SITUATION 113, 118, 128 (Koji Ishimura ed. 1993). Revenue Canada is required to maintain the confidentiality of all taxpayer information, including trade or business secrets of the type involved in advance pricing agreement negotiations. *Tax Management Portfolios No. 897 Foreign Income Transfer Pricing: Foreign Rules and Practice Outside Europe*, 897 TM VI.E.4. (1998). The U.K.'s Inland Revenue is similarly governed by very strict confidentiality rules which prohibit disclosure of any information received from taxpayers except for tax purposes, although disclosure is allowed to other nations' tax authorities under tax treaties to prevent double taxation. *Tax Management Portfolios No. 895 Foreign Income Transfer Pricing: European Rules and Practice*, 895 TM W13 (1998). The French have been especially hesitant to enter into bilateral advance pricing agreement negotiations altogether because of their strict laws against disclosure of confidential taxpayer information. The OECD, while encouraging bilateral and multilateral advance

gress has supported broad protection of taxpayer confidentiality as essential for a voluntary compliance system.[156] "In the tax statute, however, Congress has decided that, with respect to tax returns, confidentiality, not sunlight, is the proper aim."[157]

Entities contemplating the advance pricing agreement process have already expressed concern over confidentiality with respect to the extensive disclosures required.[158] To reach agreement with the IRS on the appropriate transfer pricing methodology, a multinational corporation is required to provide sensitive financial and proprietary technical data concerning business organization and cost structures, relationships with controlled entities, divisions of responsibility, and research and production activities. Required publication of advance pricing agreements, even in redacted form, could result in a decrease in the number of such agreements sought and a corresponding increase in audits and litigation over transfer pricing issues.[159] The court decisions requiring disclosure of other IRS documents have resulted in a reduced generation of the same, so that the public has in fact received less guidance than before.[160]

Finally, there is some argument published advance pricing agreements would not be particularly useful, anyway. Under current practice, the bases of transfer pricing methodologies are unique to each entity's organizational, financial, and other data, hence the extensive disclosures required by Rev. Proc. 96-53, as discussed in Part II.[161] Advance pricing agreements have not adopted any uniform measurement, but rather reflect different measurements of each taxpayer's facts and circumstances.[162] Given the facts and circumstances nature of transfer pricing methodologies and advance pricing agreements, to preserve confidentiality, the IRS would have to cut out so much information that the published version would be virtually useless for taxpayer guidance purposes.[163]

As a compromise, the IRS has indicated its intent to publish industry-specific guidelines once enough advance pricing agreements have been ne-

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pricing agreements, emphasizes the importance of confidentiality, and encourages domestic rules against disclosure wherever possible. *Organisation for Economic Co-operation and Development Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Draft Text of Part II) para. 253-255,* 11 TAX NOTES INT'L 1123 (1995).

[156] *See* discussion *supra* at Part III.D. concerning documents not published.

[157] Aronson v. Internal Revenue Service, 973 F.2d 962, 966 (1st Cir. 1992).

[158] Wrappe, *supra* note 32.

[159] Tropin, *supra* note 30.

[160] *See generally* Meadows & Dobrovir, *supra* note 151 (tracing the decline in IRS generation of various documents each time the courts require the documents to be made public). *See also* Turro, *supra* note 32.

[161] MERTENS, *supra* note 1, § 45I.06.50.

[162] *Id.*

[163] *See* Meadows & Dobrovir, *supra* note 151 at 251-52 (citing Letter from John S. Nolan to William A. Dobrovir, Aug. 27, 1996).

gotiated in an industry to generate such guidelines.[164] One such notice has been issued pertaining to international financial firms trading in commodities and financial derivatives.[165] The notice described the industry, then listed the factors used and the methodology applied to those factors to calculate U.S. income.[166]

The IRS has certainly been less than forthcoming in providing guidance with respect to transfer pricing methodologies. However, to tread heavily on taxpayer confidentiality in response to the IRS's failure will only exacerbate the problem. While there is no doubt that more guidance is needed in the transfer pricing arena, this is not the best way. Instead, the focus should be on pressuring Congress and the IRS to develop more detailed general guidelines. One suggestion would be for Congress, as part of its IRS reform efforts, to expressly declare a duty of the IRS to develop and publish appropriate guidelines, or better yet, to do so themselves.

If BNA's goal is to glean transfer pricing policy information from advance pricing agreements and publish it for other taxpayers to use, the lawsuit will be unsuccessful in accomplishing that result. Advance pricing agreements will most likely cease to be used, depriving the IRS and taxpayers of a useful tax compliance tool.

B. Implications for Relationships with Foreign Trading Partners and U.S. Competitiveness

Furthermore, publication of advance pricing agreements could chill the IRS's ability to negotiate multilateral and bilateral advance pricing agreements with other taxing authorities. Changes in any one nation's tax policies necessarily have economic consequences for others in such an internationalized area as transfer pricing.[167] Therefore, failing to consider the international ramifications of a tax policy change can adversely affect international relations.[168]

Despite its early leadership in transfer pricing issues,[169] in the past several years, the United States has not been particularly responsive to the growing need for harmonizing its tax laws with those of other nations.[170] In fairness, other countries have not demonstrated leadership in the transfer pricing area, either.[171] While the advance pricing agreement program's emphasis on negotiating with the tax authorities of other nations is only one ef-

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[164] *Id.* at 51.
[165] *Id.* at 48, *citing* IRS Notice 94-40.
[166] *Id.*
[167] Palmer, *supra* note 3, at 20.
[168] *Id.*
[169] Lodin, *supra* note 14, at 240.
[170] Wickham & Kerester, *supra* note 5, at 401.
[171] *Id.* at 405.

fort, it is a step in the right direction. Advance pricing agreement processes have been developed by most if not all OECD members, as well as other nations with which the United States has substantive trade relationships.[172] However, most of the taxing authorities with which multinational corporations and the IRS have been most successful in negotiating multilateral or bilateral advance pricing agreements have strict confidentiality laws respecting taxpayer information.[173] Already in response to recent developments in BNA's lawsuit,[174] Revenue Canada has expressed concern that the redaction process will not adequately protect Canadian taxpayer's privacy.[175] Requiring the publication of advance pricing agreements in the United States would render the non-publication policies of these nations useless. Therefore, should the courts interpret the present law as requiring publication of redacted advance pricing agreements, Congress should recognize the potential ramifications of such a decision and act to change the law.

Other countries' taxing authorities have demonstrated a desire and willingness to work with the IRS to reach tax policy compromises to accomplish the goals of advance pricing agreements. For example, Japanese tax regulations require use of a different transfer pricing methodology than prescribed in the U.S. regulations.[176] However, the Japanese National Tax Administration has agreed to adopt a hybrid combination of the two methods as a compromise for advance pricing agreements with the IRS and multinational corporations.[177] Through the advance pricing agreement process, the IRS has expressed its willingness to work with the taxing authorities of other countries to reach mutually agreeable arrangements and compromises.[178] This is a trend which should be encouraged.

Should the IRS be required to publish advance pricing agreements, the taxing authorities of other nations could refuse to negotiate with the IRS under these circumstances. This refusal would reduce the ability of multi-

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[172] As of March, 1994, the IRS was involved in negotiating advance pricing agreements with Australia, Belgium, Brazil, Canada, France, Germany, Hong Kong, Ireland, Italy, Korea, Japan, Mexico, Netherlands, Norway, Singapore, Switzerland, United Kingdom, and Virgin Islands. *Tax Management Portfolios No. 890 Foreign Income Transfer Pricing: Alternative Practical Strategies*, 890 TM W30 (1998).

[173] *See* discussion *supra* note 155.

[174] *See* discussion *supra* Part III.E.

[175] *See Canadians Concerned Redacted APAs Might Disclose Canadian Firms' Identity*, DAILY TAX REP., Mar. 4, 1999. "We are uncomfortable with the whole process. We don't like the fact that we are going through this route." *Id.* (quoting the Director of Revenue Canada's Transfer Pricing and Competent Authority Division).

[176] Akamatsu, *supra* note 72, at 1110.

[177] *Id.* Note also that the Japanese National Taxation Administration revised its pre-confirmation program to conform to the U.S. advance pricing agreement program. Baik & Patton, *supra* note 77.

[178] McIntyre, *supra* note 19, at 1128.

national corporations to utilize advance pricing agreements for their United States affiliates, yet leave them faced with severe penalties in the U.S. should the IRS disapprove of their transfer pricing methodologies. Ultimately, multinational corporations could decide to locate operations in countries with less onerous tax policies.

This last point may be overextending the case for non-publication a little, but not by much. From a broader perspective, as with just about everything related to business these days, certain aspects of tax law are becoming a global concern that extends outside the borders of the United States. Accordingly, national policies with respect to such tax matters should consider the concerns and practices of other nations with whom the United States seeks to do business.

V. CONCLUSION

The conclusion of this comment is that, regardless of the court's eventual decision in the BNA case, advance pricing agreements should not be published as a matter of policy. Thus far, the United States has been the leader in the development of transfer pricing policies. However, if we do not consider the concerns of other nations in this area, the United States may find itself left behind.

Advance pricing agreements are not the ultimate solution to the jurisdictional challenges facing the world's taxing authorities. At best they are probably a temporary solution. However, for now, advance pricing agreements have proven to be an effective alternative to the litigation and uncertainty that preceded their development. And, to the extent that they have brought the world's taxing authorities to the same table, perhaps they offer a starting point from which a true international reform effort can be established. It would be a shame if BNA's short-sighted and narrow lawsuit resulted in their extinction.