

Revenue Procedure 2002-67 **Questions and Answers**

Background Information

Revenue Procedure 2002-67, 2002-43 I.R.B. 733, prescribes procedures for taxpayers who elect to participate in a settlement initiative aimed at resolving cases involving Contingent Liability Transactions that are the same as or substantially similar to those described in Notice 2001-17, 2001-1 C.B. 730. Rev. Proc. 2002-67 provides for two resolution methodologies, the Fixed Concession Procedure and the Fast Track Dispute Resolution Procedure - Contingent Liability Cases. The details of both of these procedures are set forth in the revenue procedure.

As stated in the revenue procedure, both of these resolution methodologies are designed to ensure that any tax benefits associated with the Contingent Liability Transactions resolved under the revenue procedure are claimed no more than once, in the aggregate, by the taxpayer or by any member of the taxpayer's consolidated group (or any successor thereto) at any time.

Under the Fixed Concession Procedure, an Electing Taxpayer is allowed a capital loss deduction equal to 25 percent of the amount of the capital loss reported for the sale of the transferred stock received in the Contingent Liability Transaction. To prevent a duplication of tax benefits associated with the Contingent Liability Transaction, generally, a taxpayer electing the Fixed Concession Procedure must include an amount equal to the permitted capital loss as ordinary income in equal amounts over a fifteen year period beginning with the taxable year 2003 unless no member of the Electing Taxpayer consolidated group (including any successor to such group) is at any time entitled to any tax benefit associated with the deduction resulting from the liability assumed. In lieu of including an amount equal to the permitted capital loss as ordinary income in equal amounts over a fifteen year period beginning with the taxable year 2003, a taxpayer electing the Fixed Concession Procedure may elect an alternative method to achieve the same economic result as the 15-year income inclusion using a discount rate of ten percent. The tax basis of any unsold stock held on or after October 4, 2002, is equal to the average selling price per share of the stock that was sold that generated the reported capital loss. Also, if the basis of any property other than the stock received in the purported section 351 exchange was determined directly or indirectly by reference to the basis of the stock received in the purported section 351 exchange, then the basis of such property as of the date of the Contingent Liability Transaction shall be computed as if the stock received in the purported section 351 exchange was equal to the average selling price per share of the sold stock. Further, no penalties under section 6662 will be imposed for any deficiency attributable to the resolution of the Contingent Liability Transaction under the Fixed Concession Procedure.

The Fixed Concession Procedure described in Section 5 of Rev. Proc. 2002-67 is available to taxpayers meeting the general eligibility requirements in Section 3.02 of the

revenue procedure that filed a disclosure statement under the provisions set forth in Announcement 2002-2, 2002-2 I.R.B. 304, or, if the Contingent Liability Transaction was raised during an examination and, as a result, the taxpayer was precluded from making a voluntary disclosure under Announcement 2002-2. In the latter situation, a taxpayer electing the Fixed Concession Procedure must comply with the terms set forth in Announcement 2002-2, including submission of requested information.

The Fast Track Resolution Procedure - Contingent Liability Cases may involve two phases, a negotiation phase and, if a settlement cannot be reached, an arbitration phase. Under the Fast Track Resolution Procedure - Contingent Liability Cases, an Electing Taxpayer must concede between fifty and ninety percent of the amount of the capital loss reported for the sale of the stock. The amount of the capital loss concession as well as several other issues are subject to negotiation. Issues that are not resolved during the negotiation phase are subject to binding arbitration.

Taxpayers electing either resolution methodology contained in Rev. Proc 2002-67 must enter into a closing agreement with the Commissioner that reflects the terms of the agreement. Taxpayers not electing a resolution methodology contained in Rev. Proc. 2002-67 will proceed through the normal examination and Appeals procedure and will not be eligible for the settlement, mediation, or arbitration procedures contained in Notice 2001-67 (LMSB/Appeals Fast Track Dispute Resolution Program), 2001-2 C.B. 544; Announcement 2002-60 (Extension of Test of Arbitration Procedure for Appeals), 2002-26 I.R.B. 28; and Rev. Proc. 2002-44 (Mediation Procedure for Appeals), 2002-26 I.R.B. 10.

General Questions and Answers

(1) To what extent, if any, will the Service grant extensions of time with respect to the January 2, 2003 deadline for applications prescribed in Section 4.01 of Rev. Proc. 2002-67?

In Announcement 2002-110, the Service announced that the deadline for applications under Section 4.01 of Rev. Proc. 2002-67 is extended to March 5, 2003. The Service does not anticipate any other extensions of time for submitting applications to participate in one of the settlement initiatives provided in the revenue procedure.

(2) Under what circumstances, if any, may a taxpayer withdraw its election to participate in either the Fixed Concession Procedure or the Fast Track Dispute Resolution?

If, before an application is accepted into one of the resolution programs contained in Rev. Proc. 2002-67, a taxpayer wants to withdraw its application to participate in one of the resolution methodologies contained in the revenue procedure, the taxpayer should

send a letter to the Office of Tax Shelter Analysis (OTSA) notifying OTSA of the withdraw.

Once a taxpayer's application has been accepted into the program, Rev. Proc. 2002-67 does not provide for any circumstances in which an Electing Taxpayer may withdraw an election to participate in one of the resolution procedures. The Service, however, may deny a taxpayer's application under the Fixed Concession Procedure because the taxpayer does not satisfy the eligibility requirements under Section 5.01. If the Service denies a taxpayer's application under the fixed concession procedure because the taxpayer does not satisfy the requirements under Section 5.01, the taxpayer may amend its application within 10 days of receipt of the notice denying the application to elect the Fast Track Dispute Resolution Procedure - Contingent Liability Cases.

Under the Fast Track Dispute Resolution Procedure - Contingent Liability Cases, if an Electing Taxpayer fails to provide requested information that is in its possession or control, LMSB may elect to eliminate the Electing Taxpayer from the Fast Track Dispute Resolution Procedure - Contingent Liability Cases and Binding Arbitration Procedure.

(3) If the Service accepts a taxpayer's election to participate in one of the resolution procedures contained in Rev. Proc. 2002-67 and later determines that the underpayment of tax attributable to the Contingent Liability Transaction was due to fraud, what rules apply?

If it is determined that the underpayment of tax attributable to the Contingent Liability Transaction was due to fraud, the taxpayer is not an Eligible Taxpayer under Section 3.02 of Rev. Proc. 2002-67. As such, the case will be subject to the full range of Service audit and deficiency procedures. In addition, the Contingent Liability Transaction will not be considered under the alternative settlement, mediation or arbitration procedures contained in Notice 2001-67 (LMSB/Appeals Fast Track Dispute Resolution Program), 2001-2 C.B. 544; Announcement 2002-60 (Extension of Test of Arbitration Procedure for Appeals), 2002-26 I.R.B. 28; and Rev. Proc. 2002-44 (Mediation Procedure for Appeals), 2002-26 I.R.B. 10.

(4) May a taxpayer that elects to use one of the resolution procedures contained in Rev. Proc. 2002-67 substitute for its election an election to use the other resolution procedure?

In general, a taxpayer that elects to use one of the resolution procedures contained in Rev. Proc. 2002-67 may, before the earlier of the date the application is accepted or March 5, 2003, amend its application to elect to use the other resolution procedure. There is no other opportunity to change an election under the revenue procedure. If, however, the Service denies a taxpayer's application for participation in the Fixed Concession Procedure because the taxpayer does not satisfy either criterion in Section

5.01 of Rev. Proc. 2002-67, under section 4.05, the taxpayer may elect to use the Fast Track Dispute Resolution - Contingent Liability Cases.

(5) Section 4.04 of Rev. Proc. 2002-67 provides that the taxpayer will be notified in writing within 15 calendar days of the receipt of a complete application if the taxpayer's election has been accepted as in compliance with the eligibility and application requirements of Rev. Proc. 2002-67 for the resolution methodology selected in the application. If the Service fails to respond to an application within 15 days, does the taxpayer automatically become an Electing Taxpayer?

No. Under Section 4.04 of Rev. Proc. 2002-67, a taxpayer becomes an Electing Taxpayer for purposes of the revenue procedure after the taxpayer has been notified that its application has been accepted. There is no provision for automatic acceptance.

(6) Section 4.01 of Rev. Proc. 2002-67 provides that a separate application must be submitted for each Contingent Liability Transaction for which the taxpayer elects to participate in one of the resolution methodologies provided for under the revenue procedure. How is a Contingent Liability Transaction determined?

A Contingent Liability Transaction will be identified at the time of the transfer under the provisions of section 351. If one or more contingent liabilities were transferred as part of the same section 351 transaction, the transaction will be identified as a single transaction. If the taxpayer engages in subsequent section 351 contingent liability transactions with either the same or another entity, it will constitute a separate contingent liability transaction requiring a separate election.

(7) Revenue Procedure 2002-67 provides that taxpayers that have engaged in a Contingent Liability Transaction and meet the eligibility requirements set forth in Section 3.02 may elect to participate in the resolution methodologies contained in Rev. Proc. 2002-67. Are successor entities to entities that have engaged in a Contingent Liability Transaction eligible to elect to use a resolution methodology contained in Rev. Proc. 2002-67?

Yes. Successor entities to entities that have engaged in a Contingent Liability Transaction may elect to use a resolution methodology contained in Rev. Proc. 2002-67 provided that they are Eligible Taxpayers.

(8) What procedures apply to Contingent Liability Transactions with respect to which the taxpayer does not elect one of the resolution procedures contained in Rev. Proc. 2002-67? Will there be any restrictions on Appeals' authority to settle these cases?

Taxpayers not electing one of the resolution procedures contained in Rev. Proc. 2002-67 may proceed through normal channels that may include an examination of the contingent liability transaction and opportunity for an independent analysis in Appeals unless the issue is designated for litigation. If, however, the taxpayer was eligible for the resolution procedures contained in Rev. Proc. 2002-67 as set forth in Section 3.02 with regard to a Contingent Liability Transaction and did not elect to use one of the resolution procedures contained in the revenue procedure, the Contingent Liability Transaction will not be considered under the alternative settlement, mediation or arbitration procedures contained in Notice 2001-67 (LMSB/Appeals Fast Track Dispute Resolution Program), 2001-2 C.B. 544; Announcement 2002-60 (Extension of Test of Arbitration Procedure for Appeals), 2002-26 I.R.B. 28; and Rev. Proc. 2002-44 (Mediation Procedure for Appeals), 2002-26 I.R.B. 10.

Since the Contingent Liability Transaction issue is an Appeals Coordinated Issue (ACI), any Appeals settlement is also subject to the review and concurrence of an ACI Coordinator.

(9) The eligibility requirements contained in section 3.02 of Rev. Proc. 2002-67 refer to an underpayment of tax. If a taxpayer, that is an otherwise Eligible Taxpayer under Rev. Proc. 2002-67, does not have an underpayment of tax, is the taxpayer eligible to elect to participate in Rev. Proc. 2002-67?

Yes. Section 3.02(1) of Rev. Proc. 2002-67 is intended to preclude taxpayers from participating in one of the resolution methodologies contained in the revenue procedure if the underpayment of tax attributable to the contingent liability transaction is due to fraud. It is not intended to exclude taxpayers who have not yet claimed a capital loss on their return from electing a resolution methodology in Rev. Proc. 2002-67. If a taxpayer did not claim the capital loss from a contingent liability transaction on its return, the taxpayer must file a formal claim for refund for the entire capital loss, and attach a copy of that claim to its timely filed application to elect to participate in the applicable resolution procedure contained in Rev. Proc. 2002-67. Electing taxpayers should include the filing date and the filing location with the application. The amended return must be filed no later than the date the election to participate in one of the resolution methodologies is made. The amended return should be flagged "Electing Taxpayer under Rev. Proc. 2002-67."

(10) Rev. Proc. 2002-67 states that it applies to Contingent Liability Transactions that are the same as or substantially similar to those described in Notice 2001-17, 2001-1 C.B. 730. Are contingent liability transactions involving transferee partnerships under section 721 the same as or substantially similar to those described in Notice 2001-17 so that the transactions are eligible for the resolution procedures under Rev. Proc. 2002-67?

Revenue Procedure 2002-67 applies only to those transactions involving attempted transfers of certain liabilities to corporations in purported section 351 transactions.

(11) If a taxpayer who is the parent of a consolidated group engages in a section 351 contingent liability transaction, claims a capital loss from the transaction, and in a later year spins off a subsidiary, which subsequently files for bankruptcy, is the taxpayer eligible to make an election to participate in the settlement initiative under Rev. Proc. 2002-67?

Under section 3.02(3) of Rev. Proc. 2002-67, if at any time on or after October 4, 2002, a case containing the section 351 contingent liability issue is docketed in and under the jurisdiction of any court, including a bankruptcy court, the taxpayer is not eligible to make an election to participate in the settlement initiative. Since a subsidiary is severally liable for the consolidated group's income tax liability for every year the subsidiary was a member of the group, the Service may file a proof of claim in the subsidiary's bankruptcy case for the full amount of the income tax liability of the consolidated group. Accordingly, the section 351 contingent liability transaction potentially may be in litigation in the subsidiary's bankruptcy case.

Nonetheless, the Service has decided that, in the interest of effective tax administration, under certain circumstances it may be desirable to resolve the section 351 contingent liability issue with the taxpayer/parent outside of the debtor/subsidiary's bankruptcy case. Consequently, the Service generally will permit the taxpayer/parent to make an election to participate in the settlement initiative under Rev. Proc. 2002-67 unless, as of the time the taxpayer/parent files its application, the debtor/subsidiary has filed an objection to the Service's claim for income tax liabilities for any tax year affected by a section 351 contingent liability transaction, or if the debtor/subsidiary has sought a determination of the amount of that tax liability under section 505 of the Bankruptcy Code. The Service, however, retains the discretion to terminate the taxpayer/parent's participation in the settlement initiative if subsequent developments in the debtor/subsidiary's bankruptcy case warrant such action.

(12) If a taxpayer who engaged in a section 351 contingent liability transaction and claimed a capital loss from the transaction is in (or subsequently goes into) bankruptcy, what options are available to the taxpayer to resolve the contingent liability issue?

Under section 3.02(3) of Rev. Proc. 2002-67, if at any time on or after October 4, 2002, a case containing the section 351 contingent liability issue is docketed in and under the jurisdiction of any court, including a bankruptcy court, the taxpayer is not eligible to make an election to participate in the settlement initiative. Thus, a taxpayer who is in bankruptcy is not eligible to make an election to participate in this settlement initiative.

This does not mean, however, that the taxpayer must litigate the issue in order to have it resolved. On the contrary, the taxpayer may attempt to resolve the matter administratively with the Service's Appeals function. While jurisdiction to settle cases in bankruptcy generally rests with the Department of Justice, the Service's Appeals function retains full settlement authority under an agreement with the Department of Justice if the case can be resolved within certain time frames. If a taxpayer is unable to resolve the matter while the Service retains full settlement authority, the taxpayer may attempt to resolve the matter through negotiations with the trial attorney from the Department of Justice, Tax Division, who is assigned to the case.

Under neither approach, however, is the taxpayer entitled to the terms set forth under the fixed concession procedure (section 5) or the fast track dispute resolution procedure - contingent liability cases (section 6) of Rev. Proc. 2002-67; the availability of those settlement options are only guaranteed to those electing taxpayers, as defined in section 4.04 of Rev. Proc. 2002-67, who satisfy all of the requirements set forth in that revenue procedure. Hence, the parties are free to settle the issue on a basis that is reflective of the hazards of litigation, subject to the requisite governmental approvals. In short, a taxpayer who is in bankruptcy is not precluded from obtaining a settlement that is roughly equivalent to one under the revenue procedure, but the taxpayer is not automatically entitled to that result. The resolution must be arrived at on the merits without regard to the provisions of Rev. Proc. 2002-67. Moreover, the settlement that is negotiated by the parties must be approved by the bankruptcy court.

Fixed Concession Procedure Questions and Answers:

(13) Are taxpayers that do not have underpayments of tax attributable to the Contingent Liability Transaction eligible to elect the Fixed Concession Procedure?

Yes. A taxpayer that meets the general eligibility requirements contained in Section 3.02 of Rev. Proc. 2002-67 may elect to use the Fixed Concession Procedure contained in Section 5 of the revenue procedure if it meets the additional eligibility requirements in Section 5.01.

(14) Is a taxpayer that is the transferor in a Contingent Liability Transaction in which the liability was assumed before October 18, 1999, eligible to elect Fixed Concession Procedure, if the transferor did not file a disclosure statement under the provisions of Announcement 2002-2 because the transferor did not claim a capital loss on an original tax return filed before April 23, 2002?

Yes. If the taxpayer did not report the capital loss from the sale of the stock on an original federal income tax return that was filed before April 23, 2002 and it files an

amended return to report the contingent liability transaction, the taxpayer may elect the Fixed Concession Procedure.

Conversely, if a taxpayer reported the sale of the stock on their federal income tax return filed before April 23, 2002 but was precluded from claiming a tax benefit during the year of the transaction or carryback/carryforward years because of limitations, and failed to disclose the transaction in accordance with Announcement 2002-2, the taxpayer is not eligible to elect the Fixed Concession Procedure. However, if a taxpayer reported the sale of the stock on their federal income tax return filed before April 23, 2002 but was precluded from claiming a tax benefit during the year of the transaction or carryback/carryforward years because of limitations, and failed to disclose the transaction in accordance with Announcement 2002-2 because the Contingent Liability Transaction was already raised during an examination, the taxpayer is eligible to elect the Fixed Concession Procedure.

(15) To what extent are penalties applicable to Taxpayer's participating in the Fixed Concession Procedure?

Under Section 5.05 of Rev. Proc. 2002-67, taxpayers electing the Fixed Concession Procedure are not subject to the accuracy-related penalties under section 6662 for any deficiency attributable to the resolution of the Contingent Liability Transaction under the Fixed Concession Procedure.

(16) Does the Fixed Concession Procedure contained in Section 5 of Rev. Proc. 2002-67 include a determination of the entity that is entitled to the tax benefits resulting from the assumed liability?

Under the Fixed Concession Procedure contained in Section 5 of Rev. Proc. 2002-67, the entity entitled to the tax benefits resulting from the assumed liability will depend on the facts.

(i) If the taxpayer and the transferee corporation are part of the same consolidated group on the date that the taxpayer becomes an Electing Taxpayer, then the taxpayer and not the transferee corporation is entitled to the tax benefits resulting from the assumed liability. However, if the taxpayer agrees that neither it nor a related party will ever contribute, or otherwise cause to be contributed, to the transferee corporation an amount of additional assets other than a de minimis amount, then the parties may specify in the closing agreement that the transferee corporation and not the taxpayer is entitled to the tax benefits. Whichever rule applies, both the taxpayer and the transferee corporation must agree in the closing agreement to be bound by the result notwithstanding any future deconsolidation;

(ii) If the taxpayer and the transferee corporation are not members of the same consolidated group on the date that the taxpayer becomes an Electing Taxpayer, then the transferee corporation and the taxpayer may agree that the taxpayer is entitled to any tax benefits resulting from the assumed liability and the transferee corporation is not entitled to any tax benefits resulting from the assumed liability. The taxpayer and the transferee corporation must agree in closing agreements to be bound by this outcome. In the event that the taxpayer and the transferee corporation enter into this agreement, the taxpayer must also agree to include an amount equal to the permitted capital loss in ordinary income as if the transferee corporation joined in filing the consolidated return; and

(iii) If the taxpayer and the transferee corporation are not members of the same consolidated group on the date that the taxpayer becomes an Electing Taxpayer and the transferee corporation and the taxpayer do not agree that the taxpayer is entitled to any tax benefits resulting from the assumed liability, then the taxpayer may not claim any tax benefits resulting from the assumed liability. The taxpayer must agree in the closing agreement to be bound by that outcome, which outcome shall be set forth in the closing agreement and shall continue to apply notwithstanding any future re-consolidation. In addition, the taxpayer must agree that neither it nor a related party will ever contribute, or otherwise cause to be contributed, to the transferee corporation an amount of additional assets other than a de minimis amount. The transferee corporation will be considered the entity entitled to claim any otherwise allowable tax benefits arising from the assumed liability.

(17) In order to prevent a duplication of tax benefits associated with the Contingent Liability Transaction, Section 5.02 of Rev. Proc. 2002-67, dealing with the Fixed Concession Procedure, provides that the Electing Taxpayer must include an amount equal to the permitted capital loss as ordinary income in equal amounts over a 15-year recovery period beginning with the taxable year 2003. Electing Taxpayers have the option of an alternative method to achieve the same economic result as the 15-year recovery based on a discount rate of ten percent. What alternative method is available for the 15-year income inclusion?

In lieu of including an amount equal to the permitted capital loss as ordinary income in equal amounts over the 15-year recovery period beginning with the taxable year 2003, Electing Taxpayers may elect to include in income, in the taxable year in which the closing agreement is signed, an amount equal to the present value of the 15-year recovery of the permitted capital loss based on a discount rate of ten percent. No other alternative methods are available.

(18) Section 5.02 of Rev. Proc. 2002-67 provides that under the Fixed Concession Procedure, the Electing Taxpayer must include an amount equal to the permitted capital loss as ordinary income in equal amounts over a period of 15 years

beginning with the 2003 taxable year, unless no member of the Electing Taxpayer's consolidated group (including any successor to such group) is at any time entitled to the tax benefits associated with the deduction resulting from the liability assumed in the transaction. What taxpayers must make the inclusion in ordinary income to prevent duplication of tax benefits?

In general, an Electing Taxpayer must make the inclusion in ordinary income if the taxpayer and the transferee corporation that assumed the contingent liability in the purported section 351 exchange (the "transferee corporation") are part of the same consolidated group on the date that the taxpayer becomes an Electing Taxpayer. Except as described below, the income inclusion requirement will not apply if the transferee corporation is not a member of the taxpayer's consolidated group at the time the taxpayer becomes an Electing Taxpayer.

If the taxpayer and the transferee corporation are not part of the same consolidated group on the date that the taxpayer becomes an Electing Taxpayer, the inclusion in ordinary income to prevent duplication of any tax benefits applies to any deductions claimed within the consolidated group prior to deconsolidation. See Q&A 19. In addition, if the taxpayer and the transferee corporation are not part of the same consolidated group on the date in which the taxpayer becomes an Electing Taxpayer and the transferee corporation either carries back tax benefits to the taxpayer's consolidated group or becomes a member of the taxpayer's consolidated group (or some member of taxpayer's consolidated group becomes a successor to the transferee corporation) at sometime in the future, the income inclusion requirement applies to the extent provided in Q&A 20.

(19) If the transferee corporation was a member of the taxpayer's consolidated group prior to the taxpayer becoming an Electing Taxpayer under Rev. Proc. 2002-67, but is not a member at the time the taxpayer becomes an Electing Taxpayer, how is the ordinary income inclusion requirement applied?

Under the Fixed Concession Procedure and the Fast Track Dispute Resolution Procedure, if the entity claiming the tax benefits associated with the assumed liability was a member of the taxpayer's consolidated group, but is no longer a member of the taxpayer's consolidated group at the time the taxpayer becomes an Electing Taxpayer, the terms of the settlement must ensure that the provisions of Section 1.03 of Rev. Proc. 2002-67 are adhered to.

Under the Fixed Concession Procedure, if the deductions claimed within the consolidated group (including any deductions arising from the carryback of any of the tax benefits into the taxpayer's consolidated group if such carryback is effective prior to the time taxpayer becomes an Electing Taxpayer), equal or exceed the amount of the permitted capital loss (25 percent), then under Section 5.02, the Electing Taxpayer

must include an amount equal to the permitted capital loss as ordinary income in equal amounts over 15 years beginning in 2003. However, if the taxpayer can establish that the deductions claimed prior to the deconsolidation did not equal or exceed the permitted capital loss under the Fixed Concession Procedure, then the Service will reduce the amount to be included in income. For example, if at the time of the election the transferee had claimed \$15 million of deductions attributable to the liability during the years it was a member of the consolidated group and the 25 percent allowance of capital loss equals \$25 million, the taxpayer would be required to recapture only \$15 million over 15 years (2003 - 2017) as ordinary income. Taxpayer would also be required to include in income an additional \$10 million in the event of a later re-consolidation.

(20) Where the taxpayer and the transferee corporation do not join in filing a consolidated return in the year the taxpayer becomes an Electing Taxpayer under the Fixed Concession Option and there is ever a carryback of any of the tax benefits into the taxpayer's consolidated group (or any successor thereto) after taxpayer becomes an Electing Taxpayer, or if the transferee corporation re-consolidates with the taxpayer's consolidated group or any successor thereto (or any member of taxpayer's consolidated group becomes a successor to the transferee corporation), what is the effect on the income inclusion requirement?

If there is ever a carryback of any of the tax benefits into the taxpayer's consolidated group or any successor thereto effective or after the time taxpayer becomes an Electing Taxpayer, or if the transferee corporation re-consolidates with the taxpayer's consolidated group or any successor thereto (or any member or taxpayer's consolidated group becomes a successor to the transferee corporation, collectively, a "re-consolidation"), then when any carryback into the consolidated group occurs or upon re-consolidation (whichever first occurs) the taxpayer must, generally, report as ordinary income an amount equal to the permitted capital loss.

If the carryback or re-consolidation ("a triggering event") occurs in or prior to 2003, the Electing Taxpayer would include an amount equal to the permitted capital loss as ordinary income in equal amounts per year over a period of 15 years beginning with the 2003 taxable year or the Electing Taxpayer would include as ordinary income in the taxable year of the triggering event, an amount that will achieve the same economic result as the 15-year recovery beginning in 2003 based on a discount rate of ten percent beginning in the taxable year 2003.

If the triggering event occurs after 2003, the Electing Taxpayer would include an amount in ordinary income equal to the ordinary income that would have been reported if the triggering event occurred before 2004 (including an adjustment for interest) for the balance of the recapture period. The Electing Taxpayer would have the option of the

alternative method to achieve the same economic result as the 15-year recovery beginning in 2003 based on a discount rate of ten percent.

If the taxpayer had previously included in income a portion of the permitted capital loss, the amount of the income inclusion would be reduced by the amount of the previous income inclusion. See Q&A 19.

In lieu of the income inclusion requirement when a re-consolidation occurs, the parties may agree that the consolidated group will (i) waive all future deductions resulting from the assumed liabilities and treat such expenses as non-deductible, non-capitalizable items and (ii) waive all carryforwards associated with the Contingent Liability Transaction into the consolidated group.

(21) Where the 15-year ordinary income inclusion requirement contained in section 5.02 of Rev. Proc. 2002-67 otherwise applies, will the requirement be deferred until the deductions resulting from the assumed liability may properly be taken?

No, the 15-year inclusion in ordinary income commences regardless of whether any party has as yet become entitled to the deductions.

(22) If the taxpayer and the transferee corporation are members of the same consolidated group on the date that the taxpayer becomes an Electing Taxpayer under Rev. Proc. 2002-67, and, alternatively, (i) the taxpayer included the full present value of the 15-year ordinary income inclusion stream in income in the taxable year of signing the closing agreement, or (ii) the taxpayer has begun the 15-year ordinary income inclusion and at some time in the future before the full amount is included in income the transferee corporation deconsolidates from the taxpayer's consolidated group, is there any adjustment of the income inclusion for the portion of the recovery period that the taxpayer and the transferee corporation are deconsolidated?

In both case (i) and case (ii), the taxpayer gets no refund respecting the ordinary income inclusion. Further, if, in case (ii), the closing agreement specifies that the taxpayer is the entity entitled to any tax benefits associated with the Contingent Liability Transaction, the taxpayer must complete the 15-year ordinary income inclusion as set forth in the closing agreement. If, in case (ii), the closing agreement specifies that the transferee corporation is the entity entitled to any tax benefits associated with the Contingent Liability Transaction and the deductions claimed within the consolidated group, equal or exceed the amount of the permitted capital loss (25 percent), then under Section 5.02, the Electing Taxpayer must include an amount equal to the permitted capital loss as ordinary income in equal amounts over the 15 year period

beginning in 2003. However, if the deductions claimed prior to the deconsolidation did not equal or exceed the permitted capital loss under the Fixed Concession Procedure, then the amount to be included in income under Section 5.02 will reflect the amount of deductions claimed.

For example, assume that the taxpayer and the transferee corporation deconsolidated in 2005 and that the transferee corporation had claimed \$15 million of deductions attributable to the liability during the years it was a member of the consolidated group and the 25 percent allowance of capital loss equals \$30 million. Further, under the income inclusion requirement of Section 5.02, the taxpayer has included in income a total of \$4 million. Because the transferee corporation had claimed only \$15 million of deductions during the period it was part of the consolidated group and the taxpayer had included \$4 million in income prior to the deconsolidation, the remaining income inclusion amount is \$11 million. However, if the transferee corporation ever re-consolidates with the taxpayer's consolidated group, the taxpayer must include in income the additional \$15 million permitted capital loss that remains unrecovered or agree that the consolidated group will (i) waive all future deductions resulting from the assumed liabilities and treat such expenses as non-deductible, non-capitalizable items and (ii) waive all carryforwards associated with the Contingent Liability Transaction into the consolidated group.

(23) Section 5.06 of Rev. Proc. 2002-67 provides that the tax basis of any unsold stock shall be equal to the average selling price per share of the stock that was sold that generated the reported capital losses. Also, Section 6.03 includes a cross-reference to the same provision. If the taxpayer sold no shares of a particular class of stock received back in the purported section 351 exchange, how is the tax basis of the stock of that class adjusted?

If there is no selling price to use to adjust the tax basis of stock of a particular class, then the re-determined basis for purposes of sections 5.06 and 6.03 shall be the fair market value of the stock of that class immediately after the stock was received by the shareholder in the purported section 351 exchange.

Fast Track Dispute Resolution Procedure Questions and Answers:

(24) If the transferee corporation was a member of the taxpayer's consolidated group prior to the taxpayer becoming an Electing Taxpayer under Rev. Proc. 2002-67, but is not a member at the time the taxpayer becomes an Electing Taxpayer, how is the ordinary income inclusion requirement applied under the Fast Track Dispute Resolution Procedure?

Under the Fixed Concession Procedure and the Fast Track Dispute Resolution Procedure, if the entity claiming the deductions was a member of the taxpayer's consolidated group, but is no longer a member at the time the taxpayer becomes an Electing Taxpayer, the terms of the settlement must ensure that the provisions of Section 1.03 of Rev. Proc. 2002-67 are adhered to.

Under the Fast Track Dispute Resolution Procedure (Section 6.02), the parties will consider the identity of the corporation entitled to any tax benefits and the manner and timing of the reduction of tax benefits necessary to eliminate any duplication in the tax benefits associated when formulating a resolution. Section 6.05 provides that to the extent that the tax benefits associated with the deduction resulting from the liability assumed in the Contingent Liability Transaction are taken into account by the transferor or an entity that was a member of the transferor's consolidated group (including any successor to such group) at any time, the Electing Taxpayer must negotiate or arbitrate to eliminate any duplication in the tax benefits associated with the Contingent Liability Transactions using one of the two options set forth in Section 6.05.

(25) To what extent, if any, does Appeals have independent authority to resolve a case in which the taxpayer has elected the Fast Track Resolution Procedure - Contingent Liability Cases?

In cases in which the taxpayer has elected the Fast Track Resolution Procedure - Contingent Liability Cases, Appeals does not have independent authority to resolve cases. Section 6 of Rev. Proc. 2002-67 describes the Fast Track Resolution Procedure - Contingent Liability Cases. As indicated in Sections 6.11, 6.12, and 7, Appeals is an integral participant in this procedure.

Under Section 6.12, Appeals will attempt to facilitate an agreement between LMSB and the Electing Taxpayer regarding the Fast Track Resolution Procedure - Contingent Liability Cases issues, including penalties. Appeals may make a recommendation regarding the settlement of any or all issues. Only if acceptable to both parties, will the settlement proposal be recommended for acceptance. If the taxpayer agrees with the proposal and the LMSB Team Manager rejects the proposal, the proposal will be elevated to the LMSB Territory Manager for consideration.

If there are issues that are unresolved at the conclusion of the Fast Track Dispute Resolution process, the parties must enter into Binding Arbitration. Section 7 of Rev. Proc. 2002-67 describes the Binding Arbitration procedures. During this phase of the Fast Track Resolution Procedure - Contingent Liability Cases, Appeals will assign an independent Appeals employee to act as the administrator to manage and supervise the Arbitration proceeding and to act as liaison between the parties, and the Office of Chief Counsel will represent the Commissioner.

A taxpayer electing Fast Track Resolution Procedure - Contingent Liability Cases must participate in binding arbitration to resolve any issues that are not resolved in the accelerated settlement negotiations. Further, a taxpayer electing this procedure will not be eligible for any other settlement, mediation or arbitration procedure. See Section 6.01. Thus, Appeals does not have independent authority to resolve a case in which the taxpayer has elected the Fast Track Resolution Procedure - Contingent Liability Cases. Taxpayers not electing one of the resolution procedures contained in Rev. Proc. 2002-67 may proceed through normal channels that include an opportunity for an independent analysis by Appeals unless the issue is designated for litigation. Since the Contingent Liability Transaction issue is an Appeals Coordinated Issue (ACI), any Appeals settlement is subject to the review and concurrence of an ACI Coordinator.

(26) To what extent are penalties applicable to Taxpayer's participating in the Fast Track Dispute Resolution Procedure - Contingent Liability Cases?

Section 6.02 of Rev. Proc. 2002-67 provides, in part, that the penalties under section 6662 applicable to any deficiency attributable to the resolution of the Contingent Liability Transaction under this Fast Track Dispute Resolution Procedure - Contingent Liability Cases are issues that may be considered in the Fast Track Dispute Resolution Procedure - Contingent Liability Cases. However, no penalties will be asserted if the Electing Taxpayer previously disclosed the Contingent Liability Transaction in accordance with Announcement 2002-02, or if the Electing Taxpayer did not disclose because the Contingent Liability Transaction was already raised during an examination and, as a result, the Electing Taxpayer was unable to make a disclosure as outlined in Announcement 2002-02. An Electing Taxpayer that qualifies for a waiver of penalties under this provision must agree to provide the information required by Announcement 2002-02 and certify under penalties of perjury that the person signing the disclosure has examined the disclosure and that to the best of that person's knowledge and belief, the information provided contains all relevant facts and is true, correct and complete.

(27) Under the Fast Track Dispute Resolution Procedure contained in Section 6 of Rev. Proc. 2002-67, if a taxpayer claims privilege with respect to any of the material described in the information request, how will these claims be resolved?

Section 6 of Rev. Proc. 2002-67 provides procedures for accelerated examination and settlement in the Fast Track Dispute Resolution Procedure. Section 6.06 requires a taxpayer to provide the information and documents specified in Exhibit 3, Information Request, some of which information and documents could be subject to a privilege claim. The taxpayer is entitled to claim privilege with respect to any of the material described in the information request and to withhold the privileged information; however, if the Service determines the withheld information is needed to evaluate the issues presented, the Service may eliminate the taxpayer from the Fast Track Dispute

Resolution Procedure. The consequences of being eliminated from Fast Track are as stated in Section 6.09 of the revenue procedure.

(28) If it is determined under the Fast Track Dispute Resolution Procedure -- Contingent Liability Cases contained in section 6 of Rev. Proc. 2002-67 that the taxpayer and not the transferee corporation shall be entitled to the tax benefits associated with the deduction resulting from the assumed liability, must the transferee corporation agree to be bound by such outcome?

Under the Fast Track Dispute Resolution Procedure-Contingent Liability Cases contained in Section 6 of Rev. Proc. 2002-67, an Electing Taxpayer may negotiate and/or arbitrate the identity of the corporation that may claim the tax benefits resulting from the assumed liability. If it is determined under the Fast Track Dispute Resolution Procedure -- Contingent Liability Cases that the taxpayer and not the transferee corporation is entitled to the tax benefits resulting from the assumed liability, the transferee corporation must agree to be bound by such outcome. Similarly, if it is determined that the transferee corporation shall be entitled to such tax benefits, then the taxpayer must agree to be bound by such outcome. See Section 6.13 regarding the case closing procedures and closing agreements applicable to the Fast Track Dispute Resolution Procedure -- Contingent Liability Cases contained in section 6 of Rev. Proc. 2002-67.

Binding Arbitration Questions and Answers:

(29) Under the Binding Arbitration Procedure contained in Section 7 of Rev. Proc. 2002-67, the time period for requesting information and responding to information requests are short. Is there any thought of extending these time frames?

The arbitration procedure outlined in Rev. Proc. 2002-67 is designed to provide a flexible, cost-effective, accelerated means of resolving contingent liability transaction issues. Although the time periods for requesting information and responding to such requests are relatively short, we believe they are adequate given the preparation time already incorporated into the Fast Track Dispute Resolution Procedure. By the time the arbitration procedure begins, the parties should be in a position to determine likely candidates for interview and have these individuals available.

(30) Under the Binding Arbitration Procedure contained in Section 7 of Rev. Proc. 2002-67, how will witness interviews be conducted and how will objections to questions be handled?

Section 7.02 of Rev. Proc. 2002-67 provides that interviews may be transcribed and under oath. This provision is intended to permit counsel to make the information obtained in the interview available to the arbitrator. Counsel will have maximum flexibility in deciding who to interview and whether transcription of the interview is necessary. Counsel also will have discretion to determine what questions to ask and, accordingly, the scope of the questions of any interviews conducted under this provision are not limited. The taxpayer will be permitted to ask questions to ensure an impartial record is preserved. In addition, the taxpayer will be permitted to object to the form of the question, if that is helpful to the witness, and to pose objections based on privilege. We do not anticipate objections as to the scope of questions or on evidentiary grounds as these proceedings are not subject to the Federal Rules of Evidence. Objections will be noted on the transcript and the arbitrator may consider any objections in evaluating the weight to be accorded the testimony.

(31) Are differences in the language of Sections 6.02(3) and 6.03 and the language of Section 7.08 intended to imply that the standard for eliminating any duplication in the tax benefits associated with the contingent liability transaction is different in the Fast Track Dispute Resolution Procedure than it is in arbitration?

Rev. Proc. 2002-67 (see Section 7.08), and Exhibit 2 (paragraph 1(d)) state that the parties will include in their respective final offers a statement indicating the manner and timing of the reduction in the tax benefits necessary to eliminate any duplication in the tax benefits associated with the contingent liability transaction. Both in arbitration and in the Fast Track Dispute Resolution Procedure, the taxpayer may propose a method of eliminating any duplication of tax benefits using a discount rate other than ten percent. Differences between the language of Sections 6.02(3) and 6.03 and the language of Section 7.08 are not intended to imply that the standard for eliminating any duplication in the tax benefits associated with the contingent liability transaction is different in the Fast Track Dispute Resolution Procedure than it is in arbitration.

(32) Both phases of the Fast Track Dispute Resolution Procedure, accelerated settlement negotiation and arbitration, are designed to ensure that tax benefits associated with the Contingent Liability Transaction are claimed no more than once. How is this accomplished in this procedure?

In the Fast Track Dispute Resolution Procedure and in arbitration, the duplication must be eliminated either by reducing the amount of the deduction resulting from the assumed liability in an amount that in the aggregate equals the amount of the capital loss permitted, or by recouping an amount equal to the permitted capital loss by including the amount of the permitted capital loss as ordinary income. The manner and time period over which such reduction or recoupment will occur is subject to negotiation in the Fast Track Dispute Resolution Procedure. LMSB and Appeals will have

maximum flexibility and discretion in determining the manner and time period of the adjustments to deduction or income amounts. In arbitration, the parties' proposals for elimination of any duplication in the tax benefits associated with the contingent liability transaction must be set out in their respective final offers. The arbitrator will select one offer or the other and that selection will control how the income inclusion portion of the permitted loss is achieved. The revenue procedure does not provide for further negotiations on this issue after the arbitrator has selected one of the final offers.

(33) Section 7.09 of Rev. Proc. 2002-67 provides that the arbitrator will consider which of the two Final Offers presented by the parties best reflects the hazards of litigating the Electing Taxpayer's entitlement to a capital loss deduction from the sale of stock received as part of the Contingent Liability Transaction. Does this mean that the arbitrator is to consider only the hazards associated with the capital loss deduction?

Rev. Proc. 2002-67 requires the arbitrator to evaluate all elements of the final offer and determine which offer, in the aggregate, is the most reasonable. The percentage of capital loss to be permitted is only one of four elements. The identity of the entity entitled to the tax benefits associated with the deductions resulting from the assumed liability, the method for eliminating any duplication in the tax benefits associated with the contingent liability transaction and the applicability of any penalties are also elements that must be taken into account in the final offer. The parties are free to advocate their respective positions using any argument they feel is appropriate and persuasive. The only restriction is that the taxpayer may not propose a legal or factual argument in arbitration that was not submitted to LMSB and Appeals in the Fast Track Dispute Resolution Procedure. The arbitrator may evaluate the strength of each party's position however he or she sees fit. The arbitrator will select one of the final offers and will not render a decision on any specific element of the final offer.

(34) Section 7 of Rev. Proc. 2002-67 describes the Binding Arbitration Procedures applicable if the parties do not reach agreement in the accelerated negotiations of the Fast Track Dispute Resolution Procedure. To what extent, under the Binding Arbitration Procedures, may the taxpayer present witness testimony to meet its burden of proof?

Neither the revenue procedure, nor the arbitration agreement give the taxpayer the right unilaterally to present witness testimony. The decision to hear witnesses and the selection of witnesses will be made by the arbitrator, unless the arbitrator delegates this decision to the parties. The taxpayer, however, is in control of the facts. Accordingly, the taxpayer has the opportunity to make sure the factual record is sufficiently complete to meet its burden of proof. If the arbitrator decides to hear testimony, the witnesses will be questioned by counsel for each party. The arbitrator also may ask questions.

(35) Will the Appeals employee acting as the administrator in the arbitration phase of the Fast Track Dispute Resolution Procedure be someone involved in the negotiation phase of the Fast Track Dispute Resolution Procedure and will the administrator copy the parties on all communications from the administrator?

The administrator will not be someone involved in the Fast Track Dispute Resolution Procedure. Because the administrator is available to both parties to answer general procedural questions about the arbitration, both parties may not be included in all communications with the administrator. Both parties will, however, be copied on any written communication from the administrator, as well as on any written communication sent to the administrator for forwarding to the arbitrator. In addition, we expect the administrator to ensure both parties are available for any discussions of substantive matters.

(36) In the arbitration phase of the Fast Track Dispute Resolution Procedure, after the Electing Taxpayer selects a neutral arbitrator from the Qualified List, how will the arbitrator be hired?

As set forth in Section 7.05 of Rev. Proc. 2002-67, the administrator will arrange for the hiring of the arbitrator, subject to applicable rules and regulations for government procurement. To some extent these rules should control the amount of the arbitrator's fees and reimbursable expenses. We anticipate the administrator, the taxpayer and candidate will all participate in any negotiations concerning fees and expenses.

(37) Under the Fast Track Dispute Resolution Procedure - Contingent Liability Cases and Binding Arbitration Procedure, how will objections regarding statements of facts be resolved?

In submitting the administrative record and stipulation of facts, Section 7.13 of Rev. Proc. 2002-67, permits the parties to object to statements of fact not previously presented. These objections will be resolved by the administrator. If the administrator and the objecting party are unable to resolve the dispute, the objection will be noted on the record and forwarded to the arbitrator.

(38) Under the Fast Track Dispute Resolution Procedure - Contingent Liability Cases and Binding Arbitration Procedure, how will the arbitrator be selected?

The Service is working on putting together a list of qualified neutrals. The list will be published as soon as it is available. The taxpayer will have the opportunity to select candidates from the list in order of preference. The list of neutrals will be developed by the Service, with the assistance of the American Arbitration Association (AAA), a neutral, nonpartisan, not-for-profit service organization. See News Release IR-2002-

126, released on November 22, 2002, for more information regarding the process. See also AAA's web site at www.adr.org.

(39) Section 6.02 of Rev. Proc. 2002-67 sets forth four issues to be considered under the Fast Track Dispute Resolution Procedure - Contingent Liability Cases. May a taxpayer electing to participate in the Fast Track Dispute Resolution Procedure - Contingent Liability Cases choose which of those four issues are to be negotiated, and if necessary arbitrated?

No, resolution of all four issues must be negotiated, and if the negotiations are unsuccessful and the case is submitted to arbitration, all four issues must be taken into account in each party's final offer in arbitration.