DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR JODY TANCER
ASSOCIATE AREA COUNSEL (FINANCIAL SERVICES AND HEALTHCARE) CC:LM:FSH:BRK

FROM: Jasper L. Cummings
Associate Chief Counsel (Corporate) CC:CORP

SUBJECT:

This Chief Counsel Advice responds to your memorandum dated January 23, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Parent	=
Acquiror	=
Merger Sub	=
Sub 1	=
Sub 2	=
New Parent	=
Business X	=
State W	=
Country X	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Corporate Officer	=
Date A	=
Date B	=
Date C	=
Date D	=

ISSUES

1. Whether the Service should deal directly with a split-off subsidiary in connection with an audit of the taxpayer, which was the common parent of an affiliated group of corporations that filed a consolidated income tax return for the years under audit.

2. Whether the requirements of section 7602(c) apply when a subsidiary ceases to be a member of a consolidated group.

CONCLUSIONS

1. The Service should not deal directly with the split-off subsidiary in this case in connection with an audit of the taxpayer.

2. The Service need not address the issue of whether the requirements of section 7602(c) apply when a subsidiary ceases to be a member of the consolidated group because the taxpayer authorized the contact in question.

FACTS

Parent was incorporated in State W as the successor to a business founded in Year 1. Parent was the common parent of an affiliated group of corporations filing a consolidated return. Parent was engaged in three businesses, one of which was Business X.

On Date A, Parent entered into an agreement and plan of merger with Acquiror, a Country X corporation engaged in one of the same businesses as Parent. Acquiror established Merger Sub. Merger Sub merged into Parent, which continued its corporate existence as a State W corporation and wholly owned subsidiary of Acquiror. Merger Sub ceased to exist.

As a condition of the merger and prior to the merger, Parent transferred Business X to Sub 1, a wholly owned State W subsidiary of Parent. Business X was then split-off into a separate, publicly owned company. Sub 1 was renamed Sub 2. The split-off occurred on Date B.

On Date C, Sub 2 submitted a letter to the Internal Revenue Service notifying the Service of the split-off, appointing Corporate Officer as its representative with regard to any audit issues related to Parent's operation of Business X, and requesting that the Service discuss any potential audit matters with Corporate Officer.

As of Date D, New Parent was the common parent of an affiliated group that includes Parent. On Date D, an officer of New Parent submitted a letter to the Service ratifying and endorsing the Date C letter.

Parent filed a consolidated return for the taxable years under audit, which are Years 2, 3, and 4. The examining agent wishes to communicate directly with Corporate Officer.

LAW AND ANALYSIS

Issue 1

Parent filed a consolidated return for the taxable years at issue. By joining in the filing of a consolidated return, the members of the consolidated group consent to be bound by the consolidated return regulations. I.R.C. § 1501; Craigie v. Commissioner, 84 T.C. 466 (1985), citing Ilfeld v. Hernandez, 292 U.S. 62 (1934).

Pursuant to Treas. Reg. § 1.1502-77(a), the common parent shall be the sole agent for each subsidiary in the group, and may act in its own name in all matters relating to the tax liability for the consolidated return year. The common parent remains the agent for the consolidated return year whether or not one or more of its subsidiaries have ceased to be members of the consolidated group.

Sub 2's Date C letter notifying the Service of the split-off did not terminate the agency relationship between Parent and Sub 2 for the taxable years at issue. Treas. Reg. § 1.1502-77(b); Craigie v. Commisisoner, supra. Sub 2's notification of its separation from the consolidated group entitles Sub 2, upon its request, to a copy of a notice of deficiency and a copy of a notice for demand for payment of such deficiency for any tax due for the consolidated return years under audit. Treas. Reg. § 1.1502-77(b) expressly provides that a subsidiary's written notification to the Service that it has ceased to be a member of the group does not limit the scope of the common parent's agency, and that a district director's failure to comply with a written request for the statutory notice does not have the effect of limiting the tax liability of the former member provided for in § 1.1502-6.

Accordingly, Sub 2's notification to the Service of the split-off does not affect Parent's status as agent for Sub 2; Parent remains the authorized agent of Sub 2 for the consolidated return years under audit, even though Sub 2 has ceased to be a member of the consolidated group.

The Service has the option of dealing directly with Sub 2, however. Treas. Reg. § 1.1502-77(a) authorizes the Service to deal directly with any member of the consolidated group with respect to the member's tax liability, provided that the Service notifies the common parent of its decision. In such a case, the member

has full authority to act for itself. See INI, Inc. v. Commissioner, T.C. Memo. 1995-112.

The examining agent in this case wishes to terminate the agency relationship and deal directly with Sub 2. Through prior business dealings, the agent has developed a good working relationship with Sub 2's representative. The agent believes that terminating Parent's agency would serve the purpose of administrative convenience.

While it is clear that the regulations authorize the Service to deal directly with Sub 2, we are unconvinced that it is in the Service's interest to exercise this authority. Treas. Reg. §1.1502-6 provides that each member of a consolidated group shall be severally liable for the group's tax for a consolidated return year. Parent and the other members of the consolidated group thus remain severally liable for any deficiency in the years under audit. See also Dividend Industries, Inc. v. Commissioner, 88 T.C. 145 (1987) (concluding that the several liability of group members justified the Tax Court's jurisdiction over the consolidated liability of members of the affiliated group not identified in the Service's notice of deficiency). If the Service terminates the agency relationship between Parent and Sub 2, the Service still must deal with Parent as the agent for the remaining members of the group in determining the several liability of the group's other members. Post-audit complexities also could arise as a result of dealing separately with Sub2 and the remainder of the consolidated group. For example, determining the proper parties for collection or refund might prove more troublesome.

Terminating the agency relationship therefore does not appear to reduce the administrative burden of examination in this case, and may in fact increase the burden. Accordingly, we do not find the agent's reason for terminating agency sufficiently compelling to outweigh the potential administrative difficulties of doing so.

Issue 2

Under section 7602(c)(1), an officer or employee of the Service may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer without providing reasonable notice in advance to the taxpayer. The statute also requires the Service to provide the taxpayer with a record of persons contacted both periodically and upon the taxpayer's request. I.R.C. § 7602(c)(2). The congressional intent behind these requirements is to provide taxpayers with (1) the opportunity to come forward with information before third parties are contacted, and (2) the means to address any business or reputational concerns arising from such contacts, without impeding the ability of the Service to make those contacts that are necessary to enforce the internal revenue laws. With this intent in mind, an interpretative approach to

section 7602(c) has been adopted that balances taxpayers' business and reputational interests with third parties' privacy interests and the Service's responsibility to administer the revenue laws effectively.

Section 7602(c)(3)(A) excepts contacts that are authorized by the taxpayer from the requirements of the statute. Because Sub 2 appointed Corporate Officer as its representative with regard to any audit issues relating to the Business X, and an officer of Acquiror ratified the appointment, contacts with Corporate Officer that are within the scope of this appointment are not subject to the requirements of section 7602(c). Accordingly, there is no need to address whether contacts with a member of the consolidated group are section 7602(c) contacts with respect to the Parent when the member ceases to be a part of the consolidated group.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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

Please call Marie Byrne at (202) 622-7750 if you have any further questions.

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By: MICHAEL J. WILDER
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