NEW TAX SHELTER REGULATIONS REQUIRE REVISION OF MOST CONFIDENTIALITY PROVISIONS IN AGREEMENTS, OFFERING MEMORANDA, ETC.

Recently adopted Treasury Regulations impose broad requirements in connection with so-called "tax shelter" transactions. "Material advisors" (including law firms and investment banks) are required to maintain detailed records of such transactions for inspection by the Internal Revenue Service. Taxpayers who participate in the transactions are required to make special filings with the IRS.

Unfortunately, the regulations' definition of tax shelter transactions subject to these requirements goes well beyond any conventional definition of that term. Due to the breadth of the regulations it will be necessary to consider their applicability in many, if not most, transactions. But one category - so-called "confidential transactions" - merits particular attention at the earliest stages of any transaction.

Unless special remedial language is added, standard confidentiality provisions in most documents and agreements will trigger confidential transaction status and the attendant record-maintenance and reporting requirements. For this purpose it is not relevant that the confidentiality provision involves standard commercial terms employed with no tax-related motivation.[1]

Fortunately, the regulations provide reasonably clear guidance as to how confidential transaction status can be avoided: from the inception of discussions regarding the transaction, each party (and its employees, representatives and other agents) must be authorized to disclose, without limitation, the "tax structure" and "tax consequences" of the transaction.[2] It will be necessary to ensure that all agreements that restrict disclosure are appropriately qualified along those lines, from the earliest point at which agreements are signed between the parties - e.g., a confidentiality agreement signed at the beginning of discussions.

A special exception for so-called "merger and acquisition transactions" allows the parties to postpone the permitted disclosure until the transaction (or discussions related to the transaction) is announced or an agreement is signed, whichever is earlier. The definition of "merger and acquisition transaction" is not expansive, however. For example, the exception does not apply to

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1 Although the regulations do not apply if no party who benefits from the confidentiality restriction makes any tax-related statements in connection with the transaction, we think it is unwise to rely on that exception in light of the frequency with which tax points become part of business negotiations.

2 This prophylaxis can be understood by bearing in mind that a particular concern of the government was highly aggressive tax shelter opinions that were delivered subject to an understanding that neither the opinion nor its substance would be disclosed to any person. The net cast by the new regulations obviously extends well beyond such opinions, however.

minority investments, or to acquisitions of interests in a partnership or limited liability company that is treated as a partnership for tax purposes.

In general, the new regulations apply to transactions that are entered into on or after February 28, 2003. Confidential transactions entered into between January 1, 2003, and February 28, 2003, may be required to be reported under prior regulations.

The foregoing provides only a very general overview of the new regulations' application to confidential transactions. We would be pleased to assist you in analyzing the application of the regulations.

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If you wish to obtain additional information regarding the new tax shelter regulations, please contact a member of the Willkie Farr & Gallagher tax department.

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