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Tax Group Of The Year: Reed Smith

By **Natalie Olivo**

Law360, New York (February 7, 2017, 1:51 PM EST) -- Reed Smith LLP's tax team has hashed out a high-stakes settlement with the government over Bayer Corp.'s $175 million in research credits denied by the IRS and successfully challenged a Pennsylvania corporate net income tax bill leveled against Nextel Inc., landing it among Law360's 2016 Practice Groups of the Year.

After Reed Smith litigated cutting-edge issues on behalf of Bayer in the company's fight against the IRS' decision to deny claims for tax credits for research expenses, including whether Bayer could rely on statistical sampling to prove its claims, the firm negotiated a settlement. Reed Smith's approach to the Bayer case, as well as its handling of Nextel's challenge to its tax bill, are among the reasons companies turn to the firm for a range of tax matters.

Lee Zoeller, chair of Reed Smith's state tax group, said clients go to the firm in part because its reputation and brand is focused on resolving taxpayers' problems, not just winning cases in litigation.

"We help companies reduce their tax assessments," said Zoeller, who is based in Reed Smith's Philadelphia office. "We reduce the tax bill or find offsets and refund opportunities. It's routine for us to turn a $5 million assessment into a multimillion-dollar refund. We take a holistic approach to solve the client's problem."

As for international tax matters, James Tandler, vice chair of the firm's global corporate group, said that with the firm's global corporate platform, "we offer substantial boots-on-the-ground, and significant depth of experience, for multi-jurisdictional tax issues throughout the U.S. and Europe."

In the Bayer refund dispute, Reed Smith represented the company when it sued the IRS in 2009 over $175 million in disallowed credits stemming from research the company had done over the course of 17 years.

According to John McIntyre, a partner based in the firm's Pittsburgh office who had a lead role in Bayer case, the dispute involved more than $6 billion in research spending by Bayer over that period.

"Bayer wanted to find a way to make the case more manageable, particularly for the court, so I think that was one reason why Bayer turned to us," McIntyre said.

To tackle such a large refund dispute, McIntyre said that Bayer and the government negotiated a number of protocols to sample cost centers at some of the company's research centers. However, the government ultimately moved for partial summary judgment, arguing that Bayer hadn't sufficiently linked all of its qualified research expenses to specified business components.

But a Pennsylvania federal judge denied the government's request in September 2012, saying the company had gone through "Herculean" efforts to give the government the information it had demanded.

Bayer later convinced the court to let the company "use statistical sampling only to meet its burden of proof," McIntyre said. The parties in late 2015 ultimately reached a research credit settlement, which McIntyre said is "by far the largest" piece of Bayer's overall tax settlement with the government. The research credit settlement recently got approval from Congress' Joint Committee on Taxation.

As for Nextel, Reed Smith represented the company when the Pennsylvania Commonwealth Court in November 2015 said that a state tax provision that limits deductible losses violated the state's constitution by financially discriminating against the telecommunications company.

The seven-judge panel reversed an order from Pennsylvania's Board of Finance and Revenue and ordered the state Department of Revenue pay Nextel $3,938,220 following a battle over the company's 2007 tax bill and a $3 million alternative flat cap on net operating loss carryover deductions meant to help small businesses, which the court found unconstitutional as applied to Nextel.

The case is on appeal at the Pennsylvania Supreme Court.

Zoeller noted that the Nextel case "is probably one of the biggest we've handled recently, in terms of the magnitude of tax involved on a statewide basis. "

He added that "The amount in controversy for that taxpayer is not material, but it affects a significant number of taxpayers in the commonwealth."

In another taxpayer win, Reed Smith represented the family of Interstate Group Holdings Inc.'s late founder when the U.S. Tax Court ruled in April that payments the founder's wife made on her sons' life insurance policies totaling nearly $30 million shouldn't be counted as loans still owed to her estate, opening the door to lower taxes on her estate.

A trust managed by Clara M. Morrissette paid $30 million on life insurance policies for her three sons so that if one of them died, the other two could buy his shares in the family company. The policies, known as split-dollar policies, would pay out varying amounts to trusts for both Morrissette and her sons.

When Morrissette died in 2009 in her late 90s, her estate valued those policies at less than $7.5 million. But the IRS said the insurance payments should be regarded as loans and are owed back to the estate, contributing $13.8 million to what the agency pegged at a $60 million tax deficiency that brothers Donald, Arthur and Kenneth Morrissette successfully contested.

"Morrissette is the very first case that a court has decided interpreting split-dollar rules," said Jim McNair, a Reed Smith partner who represented the Morrissette family.

Kelley Miller, who also represented the Morrissette family, said that “the judge’s decision is a definitive determination that the way this plan was structured by Jim, for legitimate business purpose reasons, clearly complied with regulations that the IRS promulgated at the time and that still exist now.”

--Additional reporting by Eric Kroh, Daniel Wilson and Jack Newsham. Editing by Brian Baresch.
