Common Threads and Trends in Tax

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To try to put the evolution of tax practice in perspective is a humbling task, especially when I consider the collective wisdom of my fellow contributors to (and readers of) this issue of *The Tax Lawyer*.[1] Because I work with the federal income tax, mostly with respect to large organizations, my observations are informed by and limited to that practice.

To date, I have held two tax jobs. First, I served as a field attorney for the IRS Office of Chief Counsel, starting in San Jose and then later in Boston. Second, I joined KPMG, one of the "Big Four" public accounting firms, where I practice today. Of course, there are many differences between government service and public accounting, but common threads and trends have run through my practice. These common threads and trends support the overall and happy conclusion that tax promises to be a collegial and rewarding field for years to come.

Here are the common threads:

- The Service acts as a noble adversary in almost all cases,
- Facts matter more than anything else, and
- Tax is complicated.

Common trends include:

- More and more specialization in tax practice,
- More collaboration across disciplines, and
- The diminishing importance of the U.S. corporate income tax.

This short essay expands on each of these common threads and trends.

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[1] *See* Stef Tucker, *The Future of Our Profession*, 68 Tax Law. 279 (2015); Hon. L. Paige Marvel, *The Evolution of Trial Practice in the United States Tax Court*, 68 Tax Law. 289 (2015); Joan C. Arnold, *International Tax Grows Up: The Tax Section at 75, Subpart F at 53, and the Foreign Tax Credit at 97*, 68 Tax Law. 299 (2015); Linda Galler, *Why Do Law Students Want to Become Tax Lawyers?*, 68 Tax Law. 305 (2015); Kathryn Keneally, *From Clique to Community: The Power of Inclusion*, 68 Tax Law. 283 (2015).

I. Common Threads

A. *Noble Adversary*

Tax attorneys in the IRS Office of Chief Counsel do the same thing today as they have for generations: they represent the Commissioner of Internal Revenue in Tax Court, counsel the enforcement divisions of the Service, and work with the Department of Justice on other general litigation matters. National Office attorneys establish and coordinate technical positions as well as draft guidance for Treasury and the Service to consider implementing.

Attorneys in the IRS Office of Chief Counsel take on terrific responsibility. The organization usually allows its attorneys time to develop facts and issues in search of the right answer.[2] If a taxpayer or opposing counsel establishes facts or arguments that show that an initial determination by the Service was flawed, most Chief Counsel attorneys learn it is their job to persuade their managers (and sometimes others) to concede the matter in whole or in part. On the other hand, the Service deserves—and gets—vigorous advocates when the facts and the law are on its side. In the main, the Service and the Department of Justice Tax Division are noble adversaries, yielding the immense power they wield when appropriate.

Because most experienced government attorneys tend to yield in the face of new facts and better arguments, in a very real way taxpayers—at least well-advised taxpayers—actively participate in the formation, development, interpretation, and execution of the tax laws that govern all of us.

To be clear, this close working arrangement between taxpayers and the government is no concession by the sovereign. The active role the people play in developing the law of the United States follows from the founding principles of our Constitution. In our system of government, private practitioners serve an essential role together with Congress, the courts, Treasury, and the Service in the creation and administration of the tax law at all levels. A sovereign that unilaterally wielded the power to tax—the power to destroy—would be anathema.

B. *Facts Matter Most*

Tax rewards the curious. In tax—as in all the law—facts matter more than anything else. Unlike the rest of the law, however, our practice reaches into almost every aspect of life and business. So the variety of facts in our practice is as broad as human experience. One of my favorite examples: the observable spike in December births relative to other months over the past generation has been credited to . . . tax credits.[3] As the example shows, almost every human activity can be affected by tax considerations. So the curious tax practitioner

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[2] *See* Rev. Proc. 64-22, 1964-1 C.B. 689.

[3] *See* David Leonhardt, *To-Do List: Wrap Gifts. Have Baby*, N.Y. Times, Dec. 20, 2006 (collecting research findings).

learns a lot, for better or worse, about the world when viewed through the prism of tax. We must examine life in all its fullness to answer the riddles.[4]

And facts are messy. Nothing drives that lesson home better than preparing and trying cases. Tax litigation is rare. But the experience is invaluable, and I recommend it to all tax lawyers, planners included. One must never forget that facts are not created by a group of like-minded people sitting in a room agreeing with each other. Facts exist out in the real world, ambiguous and subject to different interpretations.

Marshal the right evidence, put the right perspective on things, and frame the transaction in the right way. When the facts are lined up right, the technical analysis usually follows along. But do not ignore bad facts or credibility issues. Litigation teaches that lesson over and over. As litigation becomes ever rarer, some tax practitioners—including some in the government—will lose the inclination and ability to test their own plans, facts, and arguments in a clear light, as an independent advisor must.[5]

C. *Tax Is Complicated*

As was said, tax reaches into almost every aspect of life and business. And life and business are complicated. So tax must be complicated.[6] The best tax practitioners are drawn to and thrive in the complexity. As F. Scott Fitzgerald wrote: "the test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time, and still retain the ability to function."[7] There are plenty of opposed ideas in tax. The trick is to reconcile them. For instance, what role does form play versus substance?[8] Does this rule trump that standard—or can they both be read together in harmony?[9] Maybe our labors are nothing more than a deadweight loss to our friends the economists, but thinking about hard tax questions is still an exciting privilege, and the work is never done.[10]

We tax lawyers seem to prefer the obscurity the complexity allows us, leaving the flash and the sizzle to the trial lawyers and the dealmakers. Outsiders glaze over when we start talking tax. We let the centenary of the income tax

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[4] Welch v. Helvering, 290 U.S. 111, 115 (1933).

[5] *See* Randolph E. Paul, Taxation in the United States 774 (1954).

[6] *See* Stewart Dry Goods Co. v. Lewis, 294 U.S. 550, 560 (1935) ("[I]t is difficult to be just and easy to be arbitrary. If the commonwealth desires to tax incomes, it must take the trouble equitably to distribute the burden of the impost. Gross inequalities may not be ignored for the sake of ease of collection.").

[7] F. Scott Fitzgerald, *The Crack-Up*, Esquire, Feb. 1936, *available at* http://www.esquire.com/features/the-crack-up.

[8] *See generally* Robert Willens, *Form & Substance in Subchapter C—Exposing the Myth*, 84 Tax Notes (TA) 739 (Aug. 2, 1999).

[9] *Compare, e.g.*, I.R.C. § 351(a) (nonrecognition rule with no business purpose requirement) *with* I.R.C. § 7701(o) (codified economic substance standard).

[10] Erwin N. Griswold, Ould Fields, New Corne: The Personal Memoirs of a Twentieth Century Lawyer 406 (1992) (internal quotation marks omitted).

pass without any fuss whatsoever. We prefer it that way. Our clients and our colleagues know the value we bring.

Yet it is possible to have too much of a good thing (even in tax), and we have more than enough tax complexity. Taxpayers and their advisors have been complaining about tax complications forever, for good reason. The opacity of the tax law can be just too much. For example, take partnership allocations. The section 704(b) regulations are generally inaccessible to most practitioners, largely un-administrable by the Service, and basically unreviewable by the courts.[11] In all but the most obvious cases,[12] both the Service and courts generally shy away from testing partnership allocations for substantial economic effect.[13] The rules are byzantine.

Even experienced tax lawyers risk missing issues. On the "taxpayer-friendly" side of the ledger, over 300 elections await the corporate taxpayer, never mind the hundreds of expired or obsolete elections littered in the Code and published guidance. Of course not all potential elections apply to a given taxpayer, but the sheer volume is maddening.

On the "taxpayer-unfriendly" side, does anyone even know how many anti-abuse rules and standards are scattered in the Code and Regulations? Most of us know about section 269, the granddaddy of them all, but what about all the other anti-abuse rules that popped up in the regulations over the past 20 years like toadstools? When was the last time, for example, you considered the anti-avoidance rule of Regulation section 1.1502-13(h)—aimed at arrangements that violate the purpose of the intercompany transaction regulations? Who among us knows offhand the specific, articulated purpose of the intercompany transaction regulations?[14]

And atop the Code (now including section 7701(o), the economic substance provision) and the published guidance rests the common law of taxation, everything from the sham transaction, step transaction, and substance-over-form doctrines to the tax benefit rule and the doctrine of elections, equitable estoppel, and so on. Too much.

Does the ever-increasing complexity of tax law have a natural limit? One would think so, but thoughtful people have been saying that tax is too complicated for a long time.[15] It remains to be seen whether our hyper-complicated tax system will collapse under its own weight (the corporate income tax

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[11] *See generally* Andrea Monroe, *Too Big to Fail: The Problem of Partnership Allocations*, 30 Va. Tax Rev. 465 (2011).

[12] *See, e.g.*, Renkemeyer, Campbell & Weaver, LLP v. Commissioner, 136 T.C. 137, 143-44 (2011).

[13] *See, e.g.*, Pritired 1, LLC v. United States, 816 F. Supp. 2d 693, 744 (S.D. Iowa 2011).

[14] Reg. § 1.1502-13(a)(1). Not me, anyway; I had to dig up the 1994 Notice of Proposed Rulemaking when the Service raised the issue in a recent examination. *See* Consolidated Groups and Controlled Groups – Intercompany Transactions and Related Rules, 59 Fed. Reg. 18011-01(C)(1) (Apr. 15, 1994).

[15] *See*, *e.g.*, Arrowsmith v. Commissioner, 344 U.S. 6, 12 (1952) (Jackson, J., dissenting) (criticizing the Supreme Court's "sporadic omnipotence in a field beset with invisible boomerangs"); Foxman v. Commissioner, 41 T.C. 535, 551 n.9 (1964).

is well on its way—more on that below), whether a better option will emerge, or whether we will just manage to tolerate ever-more complicated rules, standards, and regimes in the same way we have over the past century. We all hope for a simpler, more elegant tax system, but neither experience nor Congress offers much hope.[16]

II. Common Trends

A. *Specialization*

One necessary consequence, and perhaps cause of, tax complication is specialization among tax professionals. Only the smartest, or the most foolhardy, tax practitioner tries to work alone as a generalist on any real range of substantive tax issues. As tax professionals develop "niches," they find they can command higher fees, and they find that their generalist competitors may be at a distinct disadvantage, given the sheer number of issues and authorities in play.

We all need help. Certain principles—basis and realization, for instance—serve as guideposts, but one cannot serve clients with general principles. Too many traps lurk in the murk and the details. More and more, business tax lawyers tend to practice in larger tax groups, in larger firms, than they did a generation ago.

A generation ago, some of the titans of the tax bar bemoaned this development, asking whether the growth of larger, full-service law and other professional firms threatened the profession as a whole.[17] The answer—after a few scares in the early 2000s—is self-evident. The profession, though different, is still strong.

There are several advantages to practicing in a large firm. First and foremost is access to potential clients. Tax is not much of a retail profession, and it never has been. Tax is private. Close access to and relationships with clients is critical. Second, given the complexity of the tax law, there truly is strength in numbers. In any significant business transaction, potential tax issues can be legion.

While competent tax practitioners should be able to spot many tax issues, the truth is that specialization is now a fact of life for almost all tax practitioners. One missed issue may prove to be the decisive one. Furthermore, as a basic business proposition, well-coordinated teams usually allow more work to be done faster, more efficiently.

Of course, the larger the firm, the less the autonomy. The independent advisor must remember that these large firms are professional associations, not just businesses. The demands of the business must always be balanced by professional pride and responsibility as well as individual intellectual honesty.

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[16] Eliminating book-tax differences for publicly-traded entities would be a good start.

[17] *See, e.g.*, Randolph W. Thrower, *2001 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Is the Tax Bar Going Casual—Ethically?*, 54 Tax Law. 797, 799 (2001).

B. *Collaboration*

From time to time over the past 75 years, the ever-shifting boundary between tax accountants and tax lawyers has heated up. According to one who would know, in the early days of the ABA Tax Section, "most lawyers felt that tax was essentially work for accountants, and thus, from their point of view, a little beneath them."[18] That view soon changed, at least for the lawyers who saw the value in tax practice.[19]

It is worth noting where courts drew the line between tax accountants and tax lawyers 75 or so years ago, when the ABA Tax Section was founded. For instance, in 1943, the Supreme Judicial Court of Massachusetts held that preparing tax returns for wage-earners was not the unauthorized practice of law. Along the way, the court noted, in dicta:

> Doubtless the examination of statutes, judicial decisions, and departmental rulings, for the purpose of advising upon a question of law relative to taxation, and the rendering to a client of an opinion thereon, are likewise part of the practice of law in which only members of the bar may engage.[20]

It is fair to say that the line has shifted over time.

In the middle of the 20th century, a series of unauthorized-practice-of-law decisions barred accountants from recovering fees for certain tax work,[21] at least until federal regulations authorizing practice before federal agencies were found to preempt state rules regulating the unauthorized practice of law.[22]

In the late 1990s, the ABA grappled with the question of whether to explore so-called multidisciplinary practice changes to the model rules.[23] In 2000, the ABA House of Delegates, dominated then as it is now by representatives from state and local bar associations, rejected the proposals submitted by the MDP Commission, and history moved on. State bar rules still generally bar lawyers engaged in the practice of law from sharing fees with nonlawyers.

Despite the stand taken by the ABA House of Delegates, many clients tend to care more about getting good advice than they care about the professional designations of their advisors. In fact, many clients prefer that their advisory firms work across several different disciplines. Many potential business transactions raise strategic, valuation, transfer pricing, accounting, and financing

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[18] Erwin N. Griswold, *Is the Tax Law Going to Seed?*, 11 Am. J. Tax Pol'y 1, 4 (1994).

[19] *Id.* at 4-5 (explaining early and active cooperative efforts between the ABA Tax Section and American Society of Certified Public Accountants).

[20] Lowell Bar Ass'n v. Loeb, 315 Mass. 176, 183 (1943).

[21] *See, e.g.*, Agran v. Shapiro, 273 P.2d 619, 826 (Cal. App. Dep't Super. Ct. 1954); *In re* N.Y. Cnty. Lawyers Ass'n, 78 N.Y.S.2d 209, 221 (App. Div. 1948).

[22] Sperry v. Florida, 373 U.S. 379, 399-400 (1963) (patent case). One wonders whether the implications of *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014), if left unaddressed by Congress, might disrupt the settled expectations of the federal tax bar on what constitutes the unauthorized practice of law.

[23] *See Commission on Multidisciplinary Practice*, ABA, last accessed Jan. 12, 2015, http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice.html.

questions in addition to tax and legal issues, issues that often cross over borders and jurisdictions.

Strong professionals listen carefully to how their clients define success and then build teams and approaches to meet their clients' needs. Law firms add economists and accountants to their staff, and accounting firms hire attorneys, economists, and other finance professionals. Across the board, the general trend runs in favor of professionals and firms that do a better job of collaborating across disciplines and jurisdictions.

Now, aside from litigation and drafting legal documents, which remain the sole preserve of lawyers practicing in law firms and in-house,[24] it can sometimes be difficult (for me, anyway) to distinguish between the work product of those who practice in law firms, on the one hand, and those who practice tax in large accounting firms, on the other.[25]

C. *The Shrinking Corporate Tax*

According to the old saw, "when you tax something you get less of it." The secular trend with respect to the corporate income tax base proves the point. Over the last 75 years, U.S. multinational groups, in the aggregate, have been colossal engines for economic growth.[26] Over the same period, however, U.S. corporate tax receipts shrunk relative to other categories of U.S. receipts, as Chart 1 shows below.[27]

Put differently, Chart 1 shows that the massive growth in U.S. receipts over the past 50 years has come almost exclusively from individuals, not corporations.[28]

So while U.S. business worked hard to grow its collective book income over the past half-century, at the same time taxpayers and their advisors worked hard to produce less taxable income relative to that book income. Their efforts have paid off, as Chart 1 shows. The trend does not seem like it will stop anytime soon either since the underlying drivers are firmly entrenched, for better or worse.

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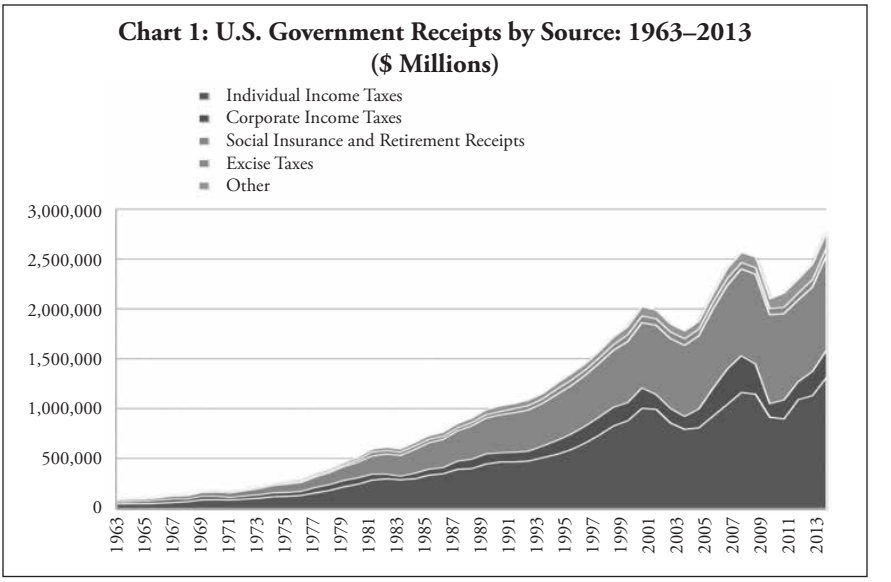
[24] Around the turn of the century, several of the large accounting firms took advantage of Tax Court Rule 200(a)(3), which allows nonattorneys to enter appearances on behalf of petitioners, but these nascent litigation practices were abandoned after at least one Tax Court judge informally signaled displeasure with the trend.

[25] In this Article, I leave aside the different risk tolerances and institutional perspectives different firms and different types of firms take with respect to substantive tax issues. Although those differences can be important, they defy generalities.

[26] *See* McKinsey Global Institute, McKinsey & Co., Growth & Competitiveness in the United States: The Role of its Multinational Companies 9 (2010) (reporting that U.S. multinationals comprise less than one percent of U.S. firms, account for 23% of private sector GDP, and more than 30% real GDP growth since 1990).

[27] Office of Management & Budget, *Historical Tables, Table 2.1—Receipts by Source: 1934–2019*, The White House, last accessed Jan. 12, 2015, http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/hist02z1.xls.

[28] I do not pretend to know anything about the economic incidence of the corporate income tax. In this context I simply refer to the data presented on tax returns.



In my view, four main drivers work to shrink the corporate tax base.

First and most obvious is the major shift of U.S. business operations away from C corporations and into pass-thrus[29] like partnerships, disregarded entities, and S corporations, as well as their cousins, Real Estate Investment Trusts, Regulated Investment Companies, and the like. Not only do pass-thrus usually avoid entity-level tax, but in comparison to C corporations they may offer business taxpayers much more tax flexibility in terms of creation, operations, and exit opportunities. The transformative effects of the limited liability company and check-the-box entity classification rules continue.

Second, large and increasing portions of the U.S. economy operate through tax-exempt organizations. Asset management, health care, and higher education are three obvious examples. When combined with pass-thru investment and operational vehicles, large portions of the economic activity in the United States permanently avoid entity-level taxation by design. Not coincidentally, I might add, asset management and health care are two of the fastest-growing elements of the overall economy. An obvious corollary to the old saying I quoted above is that if you don't tax something you may get more of it.

Third, international growth opportunities, combined with international tax planning, allow companies to create and compensate value outside the U.S. tax base, subject to limitations imposed by Subpart F and transfer pricing principles.

[29] I adopt the awkward spelling Congress uses for these sorts of entities. *See, e.g.*, I.R.C. § 1(h)(10).

For U.S. corporate multinationals, under current law the benefit of developing and growing business offshore is one of tax deferral rather than permanent tax avoidance since foreign earnings are generally subject to U.S. tax when distributed up the ownership chain to U.S. persons. Generally Accepted Accounting Principles and International Financial Reporting Standards require financial statement preparers to account for these deferred tax liabilities unless filers can produce sufficient evidence to show that the foreign earnings will be invested indefinitely or remitted in a tax-free liquidation (U.S. GAAP) or show that the filer has the ability to control the reversal of the timing difference and the timing difference will not reverse in the foreseeable future (IFRS).[30]

After the one-time repatriation holiday Congress granted taxpayers in 2004,[31] U.S. multinational groups have more than tripled their subsidiaries' undistributed foreign earnings to over $1.7 trillion, by some estimates.[32] That is a lot of cash. These balances cannot grow at this torrid pace indefinitely. Something has to give.

Finally, the last big driver of the shrinking corporate tax base is the collective set of exceptions, allowances, credits, incentives, and elections that Congress, Treasury, and the Service provide to taxpayers. Some of these provisions are targeted at particular industries or groups of industries, some apply to all taxpayers, and the net result is an uneven U.S. corporate income tax base. Some taxpayers—most notably retailers—suffer a high effective rate on their book operating income, while others pay little or no tax relative to book income. The 35% statutory federal corporate tax rate (never mind state and local levies) is a very real thing for some corporate taxpayers, but not all of them by any means.

There are other drivers that have helped to hollow out the U.S. corporate income tax base, but the four I noted above seem like the most important. Whatever the cause, the base of corporate taxable income has shrunk over time relative to corporate book income. It is not for me to say whether that is a good or a bad thing, nor is it for me to say whether Congress should junk the whole thing, but the trends described above do not seem to be slowing down, never mind reversing.

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[30] Accounting Principles Board, Financial Accounting Standards Board, Opinion No. 23, Accounting for Income Taxes—Special Areas ¶¶ 8, 12 (1972), *available at* http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820901676&blobheader=application%2Fpdf (US GAAP); International Accounting Standard 12, Income Taxes ¶ 39 (1996), *available at* http://ec.europa.eu/internal_market/accounting/docs/consolidated/ias12_en.pdf (IFRS).

[31] *See* I.R.C. § 965.

[32] *Offshore Profit Shifting and the U.S. Tax Code-Part 1 (Microsoft and Hewlett-Packard): Hearing before the Permanent Subcomm. on Homeland Sec. & Governmental Affairs*, 112th Cong. 164 (2012) (memorandum from Hon. Carl Levin & Tom Coburn).

III. Conclusion

I do not have enough confidence—no, I don't have any confidence—to guess what might happen in the future of taxation. For now, however, tax continues to be a collegial, challenging, and rewarding subject, despite some of the gripes set out in this Article. Let's leave the flash and sizzle to others, while we quietly keep doing the work we love.