June 13, 2005

The Honorable Charles E. Grassley  
Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC  20510

The Honorable Max S. Baucus  
Ranking Member  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC  20510

The Honorable William M. Thomas  
Chairman  
House Committee on Ways & Means  
1102 Longworth House Office Building  
Washington, DC  20515

The Honorable Charles B. Rangel  
Ranking Member  
House Committee on Ways & Means  
1102 Longworth House Office Building  
Washington, DC  20515

Re:  Pending Tax Legislation

Gentlemen:

I am writing on behalf of the Section of Taxation of the American Bar Association concerning recent proposals considered by Congress in connection with the tax provisions of the pending Highway Bill. The views expressed herein represent the position of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Specifically, I write with respect to certain of the revenue offset provisions that were added by the Senate to H.R. 3, the Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005. There are no comparable provisions in the House version of the legislation. Conferees were recently appointed to resolve differences between the House and Senate versions of the bill.

Economic substance doctrine. Section 5521 of H.R. 3 would attempt to codify the economic substance doctrine, and section 5522 would add a penalty for understatements attributable to transactions lacking economic substance. However well intended, these provisions may have significant ramifications for bona fide business transactions that are far removed from the tax shelter transactions that are the intended target of the legislation. Moreover, the concerns that underlie this legislation were recently addressed by the tax shelter provisions enacted late last year as part of the American Jobs Creation Act of 2004. As we have previously stated, we support legislation clarifying that when a court determines that the economic substance doctrine applies, the taxpayer must establish that the non-tax considerations in the transaction were substantial in relation to the potential tax benefits. We have similarly supported legislative clarification that in evaluating the potential economic
profit of a transaction, all costs associated with the transaction, including fees paid to promoters and 
advisers, should be taken into account. To the extent that the legislation incorporates these concepts, we 
believe it will improve the state of the law. In other respects, however, as we have previously written, we 
continue to oppose codification of the economic substance doctrine.

We further believe that enactment of the separate penalty scheme tied to satisfaction of the 
economic substance doctrine would create unnecessary complexity and confusion. The proposed penalty 
would overlap substantially with existing section 6662 and recently enacted section 6662A, and the 
coordination rules with respect to penalties under sections 6662, 6662A and 6662B are unwieldy and 
confusing. In addition, we continue to believe that a 40-percent penalty is too high, is likely to be 
administered inconsistently by the IRS and may affect a court’s decision as to whether to apply the 
economic substance doctrine in a given case.

We also urge that the Conference Committee not adopt some new and unvetted variation of 
economic substance codification. This would include the “option” proposed by the staff of the Joint Tax 
Committee earlier this year, which would introduce new concepts and formulations. Given the high level 
of uncertainty and potential for disruption of transactions that are commonly viewed as acceptable, both 
by taxpayers and the IRS, we believe it would be inadvisable to enact any proposal that has not been the 
subject of hearings by the tax-writing committees with an opportunity for comment by interested parties.

Whistleblower provisions. Section 5508 of the bill would create a new IRS whistleblower 
rewards program as well as a new IRS office to administer the program. We have previously written to 
express our reservations regarding these legislative initiatives, and continue to be concerned that the 
proposal could impair rather than enhance tax administration. If, however, you should decide to move 
forward with these provisions, we offer the following suggestions for improvement. (i) Eliminate 
monetary thresholds in the legislation, as it is impossible for most whistleblowers to know the impact on 
gross income, tax, penalties, etc., of any particular item unless they know enough about the taxpayer’s 
entire tax position. (ii) Provide jurisdiction to US district courts to review awards. (The bill would send 
these matters to the Tax Court, which does not have expertise in these areas, whereas the district courts 
are generally familiar with qui tam actions.) (iii) Provide more direction and procedures for determining 
when a claimant is eligible for the whistleblower program. This would also include clarification that 
awards are not to be provided in cases where the IRS is already pursuing an assessment or deficiency. 
(iv) Provide protection from retaliation and breach of confidentiality agreements. (v) Provide sanctions 
for frivolous claims. (vi) Include a cross-reference in proposed section 7623 of the Code to the False 
Claims Act, and vice versa.

Offers in compromise. Section 5534 of the bill proposes adding a 20-percent down payment 
requirement to lump-sum offers-in-compromise. It is apparently intended that the lump-sum down 
payment would be nonrefundable and retained by the IRS if the offer is rejected. We have serious 
concerns about this proposal. A successful offer-in-compromise program raises revenue both from the 
offer and by bringing taxpayers back into the system. Because the 20-percent nonrefundable down 
payment requirement could dramatically reduce available outside funding for potential offers, there is a 
significant risk that the proposal could decrease the number of legitimate offers submitted, the number of 
offers accepted and the number of individuals reentering the tax system. The provision also marks a 
change in direction from the 1998 Taxpayer Bill of Rights. Accordingly, we recommend that the 
proposal not be adopted or, at a minimum, deferred for further consideration.

Frivolous tax submissions. Section 5502 of the bill would revise sections 6702, 6320, 6330, and 
7122 of the Code in an effort to restrict “frivolous” submissions of requests for collection due process 
(“CDP”) hearings, applications for installment agreements and offers in compromise (“OICs”), and 
requests for taxpayer assistance orders (“TAOs”). The proposal would create two different categories of
“specified frivolous submissions”: those based upon positions the IRS has identified as frivolous and those that reflect a desire to delay or impede the administration of federal tax laws. In addition to increasing the penalty for filing frivolous returns from $500 to $5,000, it would apply the penalty to any specified frivolous submission, and would allow the IRS to disregard specified frivolous submissions. The revisions also allow the IRS to block court review of its decisions regarding frivolous submissions. As we have previously written, frivolous conduct penalties should be imposed upon taxpayers requesting CDP hearings only (i) where the request is based on arguments or positions the IRS has identified as frivolous in published pronouncements and (ii) after the taxpayer has been afforded the opportunity to withdraw the request or supplement it with information that would render the relevant published pronouncement inapplicable. By authorizing the IRS both to assess a substantial penalty and to disregard requests for CDP hearings, the proposal may eliminate one of the most important innovations of the 1998 Taxpayer Bill of Rights: the ability to petition the Tax Court where the IRS has failed to follow proper collections procedures. Low income taxpayers would be at particular risk, as the mere threat of the $5,000 penalty would be sufficient to effect the withdrawal of a submission (even if the IRS did not have the ability unilaterally to block access to the Tax Court). The proposal threatens what have become accepted as basic rights of taxpayers - to request installment agreements or OICs, to request TAOs, and to obtain administrative and judicial review of collections activity - without a showing that a large number of taxpayers are abusing these rights or that the proposed changes will result in increased collections. Moreover, we believe that the Code currently affords the government adequate protection in preventing delaying tactics by taxpayers. We, therefore, recommend that section 5502 of the bill be deferred, and that the Treasury Inspector General for Tax Administration be asked to evaluate the prevalence of frivolous submissions, and the presence or lack of existing laws and procedures to deal with these submissions.

We appreciate your consideration of these comments. Representatives of the Section would be pleased to discuss them in further detail with you or members of your respective staffs. Please contact Stuart Lewis, the Section’s Vice-Chair for Government Relations, at (202) 452-7933 if that would be helpful.

Sincerely,

Kenneth W. Gideon
Chair, Section of Taxation

cc: Hon. John Snow, Secretary of the Treasury
    Eric Solomon, Acting Assistant Secretary of the Treasury (Tax Policy)
    George Yin, Chief of Staff, Joint Committee on Taxation
    Kolan Davis, Republican Staff Director and Chief Counsel, Senate Finance Committee
    Russell Sullivan, Democratic Staff Director, Senate Finance Committee
    Robert Winters, Republican Chief Tax Counsel, House Ways and Means Committee
    John Buckley, Democratic Chief Tax Counsel, House Ways and Means Committee