NEWSLETTER

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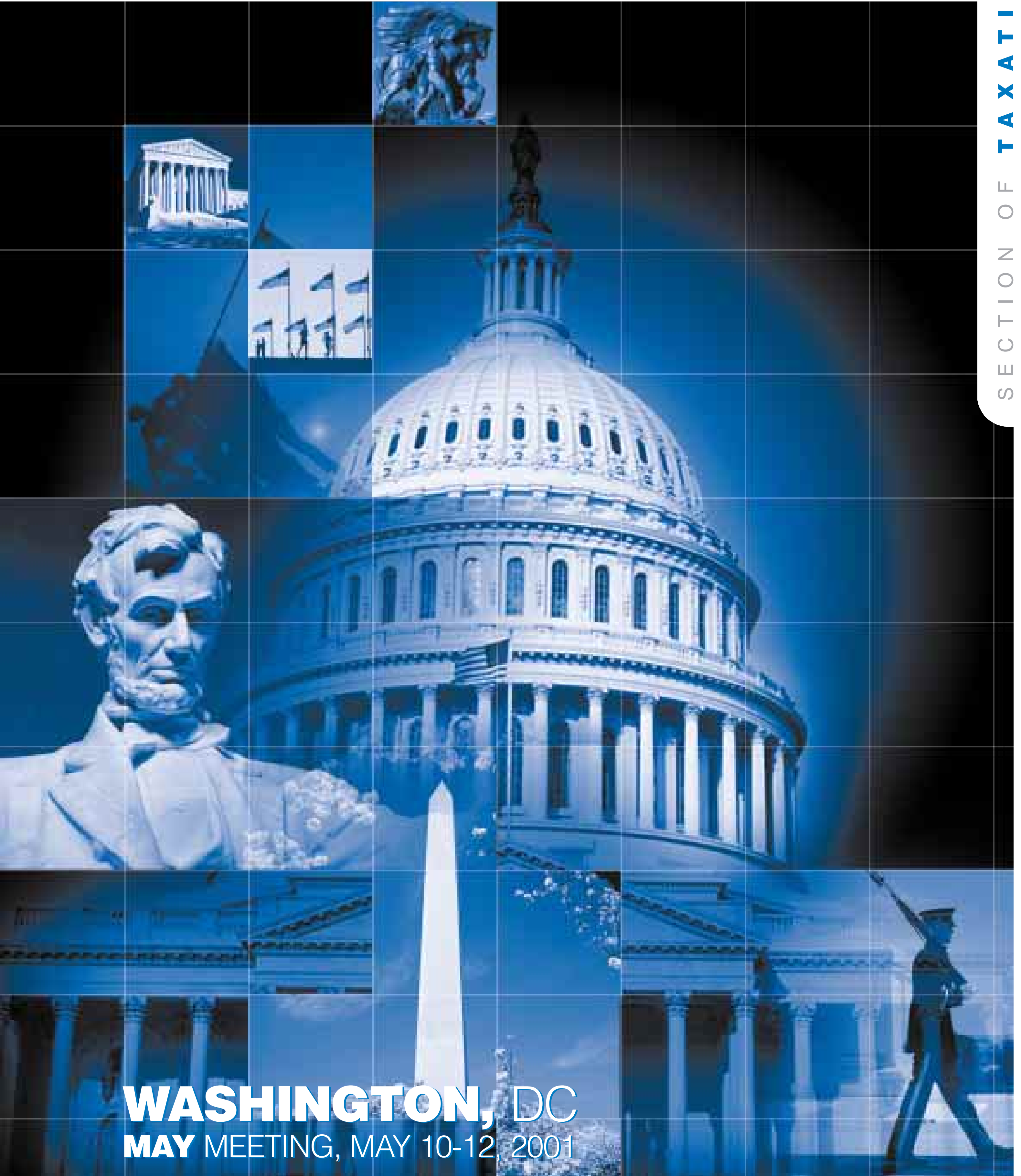
SECTION OF **TAXATION**



NEWSLETTER

ABA SECTION OF TAXATION

WINTER 2001 VOLUME 20 NUMBER 1

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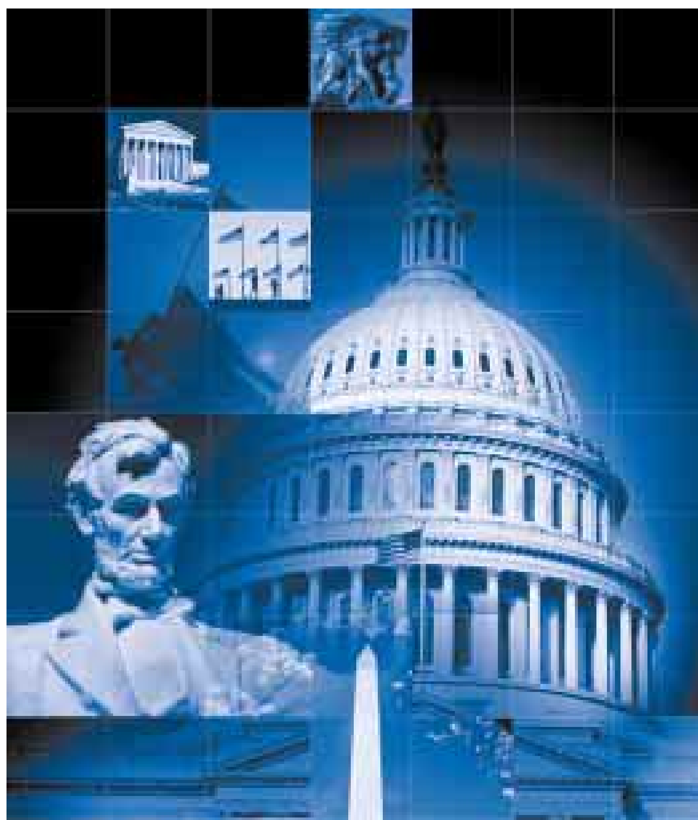

IMPORTANT SECTION **DATES AND SERVICES**

FUTURE **SECTION MEETINGS**

2001 MAY MEETING—MAY 10-12, 2001, GRAND HYATT, WASHINGTON, DC

2001 ANNUAL MEETING—AUGUST 2-4, 2001, SHERATON CHICAGO, CHICAGO, IL

2002 MIDYEAR MEETING—JANUARY 17-19, 2002, SHERATON, NEW ORLEANS, LA

2002 MAY MEETING—MAY 9-11, 2002, GRAND HYATT, WASHINGTON, DC

2002 ANNUAL MEETING—AUGUST 8-14, WASHINGTON, DC

2002 FALL MEETING—OCTOBER 17-19, CENTURY PLAZA AND ST. REGIS HOTEL, LOS ANGELES, CA*

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WHAT'S NEW ON THE WEB

WWW.ABANET.ORG/TAX/

If you haven't visited the Section website at www.abanet.org/tax/ in a few months, you're missing out! The Section home page recently was redesigned to fit more information into less space. The home page now features colored "tabs" that can be clicked to reveal an abbreviated events calendar and a description of the Section and its functions. The home page also offers links to details on upcoming CLE opportunities and to *Comm-Online*, our searchable database of presentations from past Section Meetings.

As of now, all of the Section's substantive committees have their own web pages featuring, at minimum, descriptions of each committee's purpose and its key officers. For a list of the Section's committees and links to their web pages, visit www.abanet.org/tax/groups/. Committee officers who wish to expand on their web page content should e-mail the Section's Technology Specialist, Doug Scoville, at taxweb@staff.abanet.org. ■

TAX LAWYER AND **NEWSLETTER ONLINE**

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Can't find your copy of the Section's *Newsletter*? Or, do you need to locate an article from a recent issue of the *Tax Lawyer* quickly? Both are available in PDF format on the Section's website at www.abanet.org/tax/pubs/ beginning with the Spring 2000 issue of the *Tax Lawyer* and the Summer 2000 issue of the *Newsletter*. By entering an eight-digit ABA member ID and password, Section members can view and download individual articles or an entire issue.

* Committee meetings and programs normally held at the ABA Annual Meeting in 2002 will instead be held at the Section's Fall Meeting scheduled for that year.

FROM THE CHAIR

by Pamela F. Olson, Washington DC

PAM **OLSON**

PREDICTIONS

Writing this column is a challenge because of the time lag between final copy and mailing. Today's rapid pace means that even day-old news can be *very old* news. That is never more true than now. As I write, the 106th Congress is in its final day, and we have known the identity of our 43rd President for only 48 hours. By the time you read this, the new Administration and the 107th Congress will have taken over, and we will perhaps have some sense of what they will bring us. As of today, we can only guess whether the spirit of bipartisanship evident in the presidential contestants' concession and victory speeches will prevail or whether the even divide in the presidential election and Congress will result in division in the months ahead. Served with a twist of optimism, here are my predictions for 2001—the *real* first year of the new millennium.

Bipartisanship Will Prevail. Polls indicate the American populace wants politicians to set party labels aside and work for the good of the country as a whole. An evenly divided Senate and closely divided House means the parties must work together to accomplish anything meaningful. In other words, unless party affiliation is set aside, Congress will accomplish little.

A Bipartisan Model. A reason for optimism is that Congress showed itself capable of bipartisan action even in the 106th Congress. Though much criticized for partisanship and lackluster performance, the 106th Congress passed noteworthy international trade legislation with broad bipartisan support. In sharp contrast to the 105th Congress where President Clinton was unable to muster 40 Senate votes from his own party to enact fast track trade negotiation authority, the 106th Congress enacted significant legislation covering trade with China and with Africa, replaced the foreign sales corporation provisions, enacted legislation on tariffs, and even took the first steps toward addressing contentious issues, such as trade and labor. What brought this about? Strong leadership, consensus-building, manageable goals, and a willingness to set partisan concerns aside for the common good.

Congress Will Enact Meaningful Tax Simplification. I predict the 106th Congress's model for enacting trade legislation will serve as a blueprint for legislation in the 107th Congress, particularly in the area of tax simplification. Since sharply divisive positions have no prospect for enactment, that opens opportunities for limited, but much-needed and sensible reform of our nation's tax system. The Joint Committee on Taxation is expected to release its report on simplification early in 2001. The report will provide information on the extent of the problem, ideas from which we can work to achieve meaningful simplification, and an impetus for enactment of simplification legislation. Although working on tax reform in piecemeal fashion can be difficult, the 106th Congress's trade model indicates its effectiveness.

Ending on a High Note. One piece of simplifying tax legislation is likely to be enacted on the final day of the 106th Congress. Its enactment would be consistent with the trade model. That legislation is the reinstatement of the installment sales method for accrual taxpayers, which was repealed late in 1999. The repeal generated a firestorm of protest, a number of bills, and hearings. The Tax Section testified at the hearings in support of a simple reinstatement of the method rather than the targeted reinstatement offered in some of the bills. If enacted today, the legislation will take the form of the simple repeal of the repeal for which we advocated, and our forceful advocacy of simplification will have helped to bring it about. From a tax policy perspective, the 106th Congress will have ended on a high note that could set the tone for tax legislation in the next Congress.

Loss of Transparency. The need for tax simplification is critical. The OECD (and the U.S. through its participation in the OECD) has for years urged nations to make their tax systems "transparent." The concept of transparency in administration of the laws entails a neutral application of the laws and regulations and certainty in application. It may be fairly said that our tax system runs afoul of the transparency concept because it has become so complex and is such a patchwork of targeted provisions that it is neither neutral nor certain in application. A large percentage of taxpayers rely on return preparers for the filing of even the simplest of returns. Why? For some, even the simplest return is too complicated. Others hold a genuine fear of the consequences that might follow a mistake. For many, however, the reason is a belief that other taxpayers have found ways to minimize their taxes of which they are unaware and that a return preparer will enable them to avail themselves of those tax minimization opportunities.

The Corrosive Effect of Complexity. The belief that the tax laws bestow on certain taxpayers opportunities to minimize their taxes has a corrosive effect on the tax system because taxpayers come to see the laws as unfair. The complexity in our

tax laws and its myriad targeted provisions contribute to taxpayers' concerns that somebody got something they didn't. This is a serious concern because research by social scientists suggests that, when it comes to complying with the law, the belief that the laws are legitimate and ought to be complied with has a stronger motivating effect than the fear of being caught. The potentially corrosive effect of our complicated tax laws alone suggests the need to address simplification in the coming legislative session.

Serious Simplification Candidates. Given the need for tax simplification, what should we look for in the 107th Congress? The best candidates for enactment include many of the provisions we, the AICPA Tax Division, and TEI put on our simplification top 10 list. They include:

- Repeal of the alternative minimum tax.
- Reform of the family status provisions.
- Marriage penalty relief.
- Estate and gift tax reform.
- Pension plan simplification.

There is bipartisan agreement on the need for change in these areas. If Congress focuses on the common ground, we will see the enactment of meaningful tax simplification in 2001.

Tax Administration Will Continue to Improve. A report on a recent study establishing that bread use is dangerous contained the following statistics:

- More than 98 percent of convicted felons are bread users.
- Fully HALF of all children who grow up in bread-consuming households score below average on standardized tests.

So what does this gag have to do with anything? It playfully reminds us of the ways in which statistics can be misunderstood and/or misused.

What Enforcement Statistics Can't Tell You. Much ink has been spilled recently on the decline in IRS' enforcement statistics. But like the bread user statistics, those statistics don't necessarily tell us much. Based on our annual meeting with Commissioner Rossotti and his staff in November, we believe the IRS's retooling efforts will increase efficiency and effectiveness. With the reorganization in place, the IRS is refocusing its efforts from a back-end operation to a front-end operation. That is, more resources are going to helping taxpayers get it right when they file their returns, thus minimizing the need for the much more inefficient effort of correcting filed returns. One example: last filing season, the IRS met with thousands of tax return preparers to explain the law and answer questions. That upfront compliance effort doesn't show up in enforcement statistics, but it probably has a far greater impact on collection of the correct amount of tax than an equal number of audits.

We have been pleased to participate in the IRS's modernization effort since Commissioner Rossotti took the helm. With the reorganization and a number of pilot programs complete, the new operating divisions have turned their attention to implementation. To be sure, the IRS will find bumps in the road. Among them will be staying focused on the larger picture, ensuring measured responses, and appropriately allocating resources. Too much attention to relatively insignificant matters or implementation of win-at-all-costs strategies will leave the IRS without sufficient resources to address issues that really matter. Moreover, the IRS must affirmatively leave behind its old ways of doing business if it is to keep up with the pace of change in the economy today. Changing old ways is hard, especially for large organizations.

The New Shelters. One of the bumps is tax shelters, which will continue to be an issue for the IRS, but our meeting with Commissioner Rossotti convinced us the IRS is better prepared today to address the problem. Some anecdotal evidence suggests the recent spate of court cases denying the tax benefits of a variety of shelter transactions has dampened the appetite for shelters in the corporate community. At the same time, however, there is growing concern about a perceived decrease in compliance in the individual and small and mid-size business community. Consequently, a reallocation of resources may be needed. When we met with IRS personnel, we found them focused on the issue. Some of their efforts—two significant summons enforcement cases—have already made headlines. So have several of the tax shelter rulings issued in the last several months. We expect these efforts to have a long-term, positive effect on tax compliance.

Pro Bono Publico Service Opportunities Will Increase. Ensuring the needs of low income taxpayers are met will be one of Chair-Elect Dick Lipton's themes for his year as Chair of the Tax Section. This is an area of particular interest to the IRS and we hope to work closely with them as we have on low income taxpayer clinic matters. We are working to increase the opportunities for pro bono service and putting in place a structure to advise tax lawyers of those opportunities.

I have written previously about the publication of our manual for low income taxpayer clinics. I want to thank publicly the individuals who contributed to completion of the manual. They include our authors—Jerry Borison, Nina Olson, Janet Spragens, Steven Anderson, Bill Elliott, Miriam Fisher, David Grossman, Marilyn Phelan, Gerry Kafka, Karen Kole, Robert McCallum, Bob McKenzie, Michael Mulroney, Karen Hawkins, Paula Junghans, Bob Wherry, Leslie Book—and our editors, Jody Brewster, Maureen Nelson, Troy Watkinson, Marc Gerson, Jessica Hough, Julia Kazaks, Thomas McGuire, Ken Shiu, Megan Christensen, Brian Eagan, Angie Pegram, and Becky Watt. Thank you! ■

COUNCIL ACTIONS

by N. Susan Stone, Houston, Texas

The Council of the ABA Section of Taxation met on October 15, 2000, in Carlsbad, California immediately following the 2000 Fall Meeting of the Section in Los Angeles, California. The Council heard reports and took actions on the following topics:

EVENING RECEPTION TO REPLACE COMMITTEE CHAIRS AND VICE CHAIRS BREAKFAST

Pamela F. Olson, Section Chair, proposed that the traditional Friday morning breakfast for Committee Chairs, Vice Chairs, Section Officers and Council be replaced with a reception held on the Thursday evening preceding each Section meeting. Council considered the increase in attendance and committee officer interaction that would likely result if the breakfast function was replaced with an early evening reception. After discussion, Council adopted the proposal. The first reception for Committee Chairs, Vice Chairs, Officers and Council will be held from 5:00 to 6:30 p.m. on Thursday, May 10, 2001, at The Grand Hyatt Hotel in Washington, D.C.

REORGANIZATION OF CERTAIN COMMITTEES

Don Korb, Vice Chair (Committee Operations), reported that the Closely Held Businesses Committee and the Personal Service Organizations Committee had agreed to merge to form a new committee named the "Small Business Committee". Council member Stanley Blend proposed that the Environmental Taxes Committee become a subcommittee of the Natural Resources Committee. Council member Charles Egerton proposed that the LLC Task Force be merged into the Partnerships Committee. After discussion, Council approved all of the restructuring proposals to be effective on July 1, 2001.

SYMPOSIUM ON FUTURE OF THE PRACTICE IN BUSINESS LAW

Pam Olson proposed that the Section of Taxation co-sponsor a symposium with the Business Law and Real Property, Probate and Trust Sections of the ABA. The symposium, entitled the "Future of the Practice in Business Law," is expected to be held in March 2001. Council approved the Section's co-sponsorship of, and participation in, the symposium. ■

FROM THE EDITOR

by Ellen P. Aprill, Los Angeles, CA

The overwhelming sense I have from this issue of the *Newsletter* is that, in the field of tax law as in so much of life, we all gain a great deal when we communicate and work with each other.

Pam Olson strongly sounds this theme in "From the Chair." She calls upon members of both the House and the Senate to work together across party affiliation in order to accomplish anything meaningful. She urges the model of the trade legislation of the 106th Congress, achieved through "strong leadership, consensus-building, manageable goals, and a willingness to set partisan concerns aside for the common good." As she explains, in the case of the tax law, the common good translates into simplification.

Ron Pearlman's interview also emphasizes the importance of collaboration and cooperation. In his distinguished career, Ron has worn many hats, IRS lawyer, private practitioner, Assistant Secretary for Tax Policy, Chief of Staff of the Joint Committee on Taxation, and law professor. His insider's account of the 1986 Tax Reform Act highlights how bipartisan efforts made its achievement possible.

Both the substance and the source of this issue's Point/Counterpoint further this message. Each of the four contributions reflects on the need to achieve an accommodation between policy and politics. This Point/Counterpoint has its origin in one of my favorite modes of collaboration and cooperation—*taxprof*—, which is the tax professors' electronic discussion group. Through this resource, some 200 tax professors are able to talk to each other daily, expressing opinions and soliciting advice on a

wide array of topics about both tax and teaching. Last spring, one of the contributors to this issue's Point/Counterpoint asked about the current state of tax policy. The responses were so eloquent and thoughtful that I asked several of the participants to revise them for this publication.

Taxprof enriches the life of all of us who teach taxation in our law schools. I know that I am not alone in feeling personally quite bereft if my e-mail is down or I am out of town so that I am cut off from its help, wisdom, and camaraderie. We tax professors all owe a debt of gratitude to Professor Paul Caron at the University of Cincinnati College of Law for his willingness and efforts to maintain this listserv.

In the *Newsletter*, the Points to Remember and Special Reports serve for our readers some of the same functions as *taxprof* does for its subscribers—helping us keep up with new developments. In this issue, Dianne Bennett gives us a fascinating look at some of the unusual employee benefits being offered in the marketplace. Of those she describes, I think pet health insurance may be my own favorite! Annette Nellen provides not only a review of recent new authorities, but also a handy checklist regarding capitalization versus expensing. Ed Polisher and Ed Kessel thoughtfully analyze the implication of the recent *Atkinson* case regarding the administration of charitable remainder trusts. In a Special Report, Stuart Rader demystifies allocation of the GST exemption for lifetime transfers to trusts.

Communication, of course, does not always produce agreement, as demonstrated by the exchange between Mitchell Miller and David Silverman on installment sales to defective grantor trusts or by the letter from Tax Section Chair Pam Olson to ABA President Martha Barnett regarding positions of the ABA. Without such exchanges and willingness to learn from each other, however, agreement will never be possible. May we in the Tax Section continue to learn from each other. ■

MEMBERS REACT TO **ABA JOURNAL ARTICLE**

The following letter is excerpted from an e-mail from Tax Section Chair Pam Olson to ABA President Martha Barnett in reaction to the December 2000 ABA *Journal* cover story, "Where Will They Go?,"concerning the Palestinian refugee right to return campaign.

Dear Martha:

The December *Journal* article has certainly caused a firestorm of protest. I appreciate the steps that have been taken to address the apparent one-sidedness of the article. I am writing because I wanted you to be aware of a more fundamental issue that the article appears to have brought to the surface. That issue is a current of general dissatisfaction with ABA policies among some of our members. I have copied here for your information an e-mail from Michael Shaff, a long time Tax Section member, about his concerns with the ABA. Mr. Shaff writes:

"I have been a section member for 20 years. In that time I have been a committee member (Financial Transactions for the last seven or eight years) and have participated in the FASIT regulation project and on the family partnership ruling project for the Partnerships committee about 12 years ago. I have always appreciated the *Tax Lawyer* publication and the quarterly newsletters."

"Of late, I have become increasingly more intolerant of the political positions taken by the ABA house of delegates and the positions espoused in the ABA *Journal*. My partners have let their ABA memberships lapse, and only one of our five associates remains an ABA member. Positions on abortion, capital punishment and the Middle East set forth in the ABA *Journal* recently are not in line with my views or even with the views of most Democrats, I dare say.…The ABA risks being marginalized into a left wing lobby. Being a member of the tax section of the National Lawyers Guild would have no appeal for me. The NYSBA tax section probably carries more weight than the ABA tax section in Washington these days, and the situation is likely to deteriorate under the new Administration. I call upon you to publicly advocate to the ABA leadership a moderation of the views

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POINTS TO **REMEMBER**

Editor's Note: POINTS TO **REMEMBER** are individual submissions to the *Newsletter* from Section of Taxation members with insights to share. Although these items are subject to selection and editing, the Section conducts no systematic review of these items. Accordingly, each item states the view of the individual contributor and does not necessarily represent the views of the ABA or of the Section of Taxation. We welcome new submissions as well as responses to previously published material found in this section.

CREATIVE BENEFITS

by Dianne Bennett, Buffalo, NY

From hammocks in quiet rooms (People Support) to paid dry cleaning, safe deposit boxes (First Union) to car seats for new parents (Allstate), bring your parents to work day (e-services company Organic) to pet health insurance (1% of companies surveyed), corporate America is trying to woo and retain X Generation and Next Generation employees in a market where the competition for talent has become fiercer than the competition for clients. Even Disney relaxed its 43-year ban on facial hair. But the glitz is less important than the substance. What employees really want, even more than money, according to numerous surveys, is opportunity for promotion, challenging work, and feedback—in any order. A very recent survey of call-center employees had them ranking wages fifth. Appreciation came first, and then feeling "in" on things, supervisors with an understanding attitude, and job security.

Most law firms can't compete with the campus in the modern business world that supplies medical centers, fitness centers, on-site day care and even nap and game rooms (try the Monster Den at Monster.com). But there are some changes law firms can make in their employee benefits programs. They can get more creative about vacation, sick and personal days—wrapping them into one program. In addition, employees are demanding more vacation time earlier in their tenure at firms, and quicker access to programs like 401(k) plans. These programs cost money, but if they help reduce costly turnover, they will prove cost-effective in the long run. At a recent ABA Tax Section meeting, the IRS was receptive to listening to proposed changes in their rules that will make it less burdensome for firms to provide instant entry into 401(k) plans.

Try a cappuccino bar, or a coffee grinding room, and lots of free snacks, say some companies. Or things as simple as free flu shots, which should pay off in terms of healthier employees and less sick time. All of these "perks" should fit under the Code's already outdated (coffee and doughnuts probably need to be replaced with grinding rooms and cappuccinos) section 132 on fringe benefits, and the lengthy regulations under that section. The "working condition fringe" in section 132(d) and regulation section 1.132-5, and "de minimis fringes" in section 132(e) and regulation section 1.132-6 provide most of the tax exclusions for employees. The IRS would be wise not to be too rigid as companies expand the perks they are offering. They should have learned their lesson from trying to tax frequent flyer miles and attempting to cut off kidnapped child exemptions.

The basic premise to the working condition fringe is that the expense would be deductible (without taking into account limits) under section 162 if the employee had purchased the product or service. An employer expanding its perks in this field should check carefully, for example, the provisions on cash reimbursements and the special rules under regulation section 1.132-5(a), and the rules for employer-provided home computers, because they are "listed property" under section 280F.

Appreciation—the number one employee motivator described above—sometimes is doled out as simply as passes to movies and sporting event tickets. As long as these are not season passes, they fall under the nontaxable category of de minimis fringe benefits specifically graced in regulation section 1.132-6(e). Employers going the full route of employee achievement awards need to keep in mind both the nontaxable (for the employee) and deductibility (for the employer) limitations under sections 74(c) and 274(j).

Almost all companies have some sort of arrangement for discounts these days—whether to regional restaurants or movie theaters or fitness centers. The discount program is expanding rapidly, with companies signing on for substantial discounts for products and services, many provided online, such as through realperks.com. The Internet makes discounting much easier. There should be no income tax effects to the employees if there is no cost to the employer. If the employer is providing some of its own goods and services at a discount, the "no additional cost" provisions of section 132(b) should be applied to determine if the discounts are non-taxable. See section 132(c) and the regulations for "qualified employee discounts" under section 1.132-3 as well. Benefits to spouses and dependent children are tax-free in these two categories, under section 132(h), but benefits provided to spouses and dependent children otherwise are taxable to the employee.

A company considered one of the best to work for, Lexmark International, Inc., headquartered in Lexington, Kentucky, gives employees $2,500 within five years of retire-

ment to retrain for another career, work on a hobby, or travel. The company also provides up to $2,500 for supplies for employees with children with special needs and for adoption fees. The first item would be taxable to the employee, unless the tuition fell under a section 127 educational assistance plan. The adoption reimbursements should be nontaxable if they fit within section 137, and the supplies could qualify as tax-free under a cafeteria or health plan (sections 125 and 105).

Education outside the workplace—tuition reimbursement programs that are tax-free if certain basic requirements are met under section 127—are gaining in popularity. Some companies are providing tuition for children of employees. These are taxable, but better than paying with tax-paid dollars of one's own.

In-house education is growing in importance as well. Some of the training is outside the traditional box of law and management, but most is not. Employees rightly see this as helping their own personal and professional development, a firm commitment to them as people—no matter where they end up. And, in helping them be more marketable, the firm somewhat counter-intuitively is helping bind them to the firm. Here, too, the tax issues may get tricky with training not related to law itself, but between the section 127 plan and the section 132 working condition fringes, the training should be tax-free to the employee. If the training does not fit into one of these two categories, it is taxable. See section 132(j)(8).

Family friendly is not appealing just to women. Almost the same percentage of men (82%) as women (85%) in the 20-39 age group place family time at the top of their work priority issues, according to a study this year by the Radcliffe Public Policy Center. The U.S. Census Bureau this year noted that for the first time since it started keeping track, more than half of married-couple families with wives of childbearing age had children and had both parents in the workforce. Law firms that provide flex-time schedules, telecommuting, and family leaves are likely to retain their associates and employees more than ones that do not. (Family friendly may not sit well with all employees. Something of a backlash has developed among employees without children. The movement "No Kidding!" has more than 50 chapters, to try to deal with, as they call it, a "procreation-crazed" America.)

High billables and the stress of work overall may be part of the trend toward providing home services from work. More companies are providing concierge-type services, such as dry cleaning, shoeshines and car detailing, from work. And the trend now seems to be to provide it through the Internet, with specially designed company portals, such as those sold by Abilizer (formerly perksatwork.com). There also seems to be little doubt why Salomon Smith Barney in London provides gourmet meals, fresh underwear and free toothbrushes to those who work past 7 p.m. Again, given the circumstances, these items should not be taxable to the employee.

This year's survey by the Society of Human Resource Managers (SHRM) of 600 HR managers showed some cutbacks and slowing in employee perks, especially in costly ones like vacation days and personal time. What employees likely will need most in the coming years is more time off, not less, particularly to care for elderly parents. About 25% of all U.S. households now provide care for their aging relatives. Emergency care—for children or elderly relatives—is the "perk" employees now think they will need the most. According to a Hewitt survey this year, 13% of companies it surveyed provide emergency childcare. Again, if the company cannot afford to provide the time or the space, it should look for providing the resources to get this care for its employees. In larger cities firms can negotiate with a service provider to provide a certain amount of days or hours of this type of emergency care. Traditional employee assistance programs (EAPs), which in many cases may need to meet certain welfare plan requirements under the Employee Retirement Income Security Act (ERISA) or at least the reporting requirements of section 6039, could and should be used more by firms. National usage is at about 12%; in Seattle it's about 45%—which says something about the younger and more entrepreneurial companies and how they try to keep their workers.

It's cute and it's funny to look at some of the perks being given to employees these days, whether in-firm massages (that reduce stress, so they say) or pets at work (30 out of 1,000 companies surveyed by Wm. M. Mercer Company) that also reduce stress, some say, but the climate of a workplace is extraordinarily important to today's worker, and law firms would do well to remember that.

CAPITALIZATION VS. EXPENSING: WHAT MORE DO WE KNOW FROM RECENT RULINGS?

by Annette Nellen, San Jose, CA

Whether an expenditure should be capitalized or currently expensed has been a difficult determination under the tax law for decades. Since 1992 when the U.S. Supreme Court "clarified" the capitalization versus expensing rule in the *Indopco* decision,[1] practitioners and revenue agents have perhaps been even more perplexed with the question. While there are

1 Indopco, Inc. v. Commissioner, 503 U.S. 79 (1992).

many court cases and IRS rulings on this topic, the fact that the classification of the expenditures depends on the particular facts and circumstances and the existence of, often, a "fine line" separating the two types of expenditures continues to make the determination a difficult one. In the past year, a few taxpayer-favorable rulings were issued, including two cases that overturned Tax Court decisions. This article provides a brief overview of one recent revenue ruling and three cases and summarizes what these authorities add in helping to distinguish between section 263 and section 162 expenditures.

Revenue Ruling 2000-4[2] holds that costs to obtain, maintain and renew ISO 9000 certification are currently deductible. (ISO 9000 is a series of international standards for management systems.) The Service concluded that the benefits derived from ISO 9000 certification are only incidental and are similar to current benefits of training, advertising and expenditures incurred to retain existing customers or just to improve the overall quality or attractiveness of the taxpayer's business operations. Per the Service, "these future benefits are incidental to the primary benefit of current sales" and are therefore currently deductible. The Service also referred to the *Briarcliff Candy*[3] and *Sun Microsystems*[4] to support its conclusion under section 162 that the "mere ability to sell in new markets and to new customers, without more, does not result in significant future benefits." In addition, the Service stated that ISO 9000 certification is not like obtaining a license or certification that is necessary for market-entry, which would most likely be capitalizable.

In *PNC Bancorp*[5] the Third Circuit held that costs incurred by a bank in creating loans (such as salaries and credit check fees) did not have to be capitalized because they were everyday-type expenditures and were merely associated with origination of the loans and did not become part of the loan balance. In approving a loan, including performing credit checks and appraisals, the bank did not "step out of its normal method of doing business." The court noted that there is a "fundamental distinction between business expenses and capital outlays."

In *Wells Fargo*[6] the Eighth Circuit held that officer salaries incurred in determining whether a company was a suitable merger target were only indirectly related to the acquisition and therefore did not have to be capitalized. If the cost is only "incidentally connected" with a long-term benefit, capitalization is not warranted. The court also noted that these indirect costs originated from the company's obligations to pay a salary due to the employment relationship, rather than the capital transaction.

Finally, in *Ingram Industries*[7] the Tax Court held that the cost of performing periodic cleaning and inspection to towboat engines was deductible. The court found the work to be preventative maintenance rather than overhaul work. The cost was $100,000, which represented only 1.6% of the cost of a new towboat. Also, an overhaul would take 3 to 5 months, rather than 10 to 12 days. Moreover, only about 21% of the parts were replaced. Basically, the periodic cleaning and inspection work enabled the boats to reach their 40-year useful life. The court also noted that even if the maintenance work added $100,000 in value to a boat, such amount was immaterial to the value of both the boat and the engine. Finally, the court observed that the work did not adapt the engine for a new or different use.

PRACTICE POINTS

The four authorities summarized above can be turned into four questions to help in resolving the capitalization versus expensing issue, with a "yes" answer pointing towards deductibility under section 162.

i. Is the expenditure a regular business expense that does not "attach" to the basis of any asset?

ii. Is any potential long-term benefit derived from the expenditure merely speculative or incidental?

iii. Is the expenditure one that did not create or enhance an asset or did not by itself generate anything with a future benefit (such as a credit report)?

iv. If the expenditure arose from work done to property (such as repair of equipment) that did not adapt the property to a new or different use, was the amount spent nominal compared to the replacement cost and value of the property, thus indicating that the work did not appreciably prolong the life of the property or materially add value to it?

We are likely to continue to see more cases that will expand and further clarify the above list of questions. In addition, the 2000 Treasury/IRS Business Plan lists specific expenditures for which guidance may be issued on whether the expenditure falls under section 263 or section 162. Such guidance may address the treatment of cyclical maintenance costs, sales commissions paid to obtain new customers, mutual fund launch costs, and loan origination costs.[8]

2 Rev. Rul. 2000-4, 2000-4 I.R.B. 331.

3 Briarcliff Candy Corp. v. Commissioner, 475 F.2d 775 (2d Cir. 1973).

4 Sun Microsystems v. Commissioner, T.C. Memo 1993-467.

5 PNC Bancorp Inc. et al. v. Commissioner, 212 F.3d 822 (3d Cir. 2000).

6 Wells Fargo & Co., et al. v. Commissioner, 224 F.3d 874 (8th Cir. 2000).

7 Ingram Industries v. Commissioner, T.C. Memo 2000-323.

8 *See* Rev. Rul. 2001-4, 2001-1 I.R.B._, released Dec. 21, 2000.

WALK THE TALK

by Edward N. Polisher and Edward Kessel, Philadelphia, PA

Estate of Melvine B. Atkinson v. Commissioner, 115 TC No. 3 (July 26, 2000) serves as a strong reminder that careful administration of a charitable remainder trust is every bit as important as careful drafting.

In August, 1991, the decedent created the Melvine Atkinson Charitable Remainder Annuity Trust and funded it with almost $4 million. The trust document contained all the right terms. It provided the settlor an annuity of 5% of the fair market value of the trust assets as of the date of creation. Following the settlor's death (which occurred in June, 1993) the trust instrument provided for the continuation of the 5% annuity for the benefit of secondary individual beneficiaries. The trust instrument contained a condition that the individual beneficiaries provide funds to pay their share of any state or federal death taxes for which the trust would be liable upon the settlor's death.

The trust instrument clearly met the requirements for creating a valid charitable remainder annuity trust (CRAT) under section 664(d)(1):

- The annuity was at least 5% but no more than 50% of the initial fair market value of the trust, and the payments were for the lives of individuals living at the time of creation of the trust;
- No payments (including taxes) other than the annuities were payable to any person other than a section 170(c) charity;
- Following the termination of the annuities the remainder interest passed to a section 170(c) charity;
- The value of the charitable remainder was at least 10% of the initial value of the trust.

But, two fatal flaws were made during the administration of the trust. First, the settlor never took her 5% annuity payments.[1] Second, the settlor gave one of the secondary individual beneficiaries a signed a notarized document stating that she would not be liable for her share of estate taxes. The decedent's separate estate was not large enough to cover all of the administration expenses and death taxes, and it was necessary to invade the CRAT to make up the shortfall.[2]

The settlor's failure to take her annuity payments certainly did not reduce the amount ultimately passing to charity. However, one of the goals of the legislators in drafting section 664(d)(1)(A) was to limit the amount that could be accumulated tax free and, in parity with the treatment of private foundations, to insure that each year a minimum amount would be returned to the economy and subjected to tax.[3] The failure to take the annuity payments was held, by the Tax Court, to be a fatal omission, and disqualified the trust from a charitable deduction in the settlor's estate.

The disqualification of the trust because of the tax payments on behalf of the secondary beneficiary was even clearer. Regulation section 1.664-1(6), Example (3) and Revenue Ruling 82-128[4], clearly state that a trust will not qualify as a CRAT if the grantor's taxes or debts can be paid from the trust. The result was that no charitable deduction was allowed for federal estate tax purposes.

The authors recognize that the invasion of trust assets to pay the taxes of the secondary beneficiary is a clear violation of the regulations and, standing alone, would defeat the charitable deduction in the estate. The other reason for the disallowance of the deduction, namely the failure to pay the 5% annuity amount gives us more concern.

The sample form for charitable remainder annuity trusts described in Revenue Procedure 89-21[5] tacitly acknowledges delays in paying the annuity. Even though Section 5 of the revenue procedure requires that a trust operate in a manner consistent with the terms of the agreement, Section 4, Paragraph 2 provides for a recalculation of the annuity payments in case of an incorrect determination of fair market value, and Section 4, Paragraph 3 requires a proration for a short year or for the year of death. And, example (6) of regulation section 1.664-1(a)(6) explains how to handle payments made 9 months after funding when the funding, itself, is delayed by 2 and 3/4 years. Furthermore, regulation section 1.664-3(a)(1)(b) and Revenue Procedure 90-31[6] approve income exception trusts, which grant charitable deductions for charitable remainder unitrusts (CRUTs), but not for CRATs, that pay out the lesser of 5% of net asset value or net income. Regulation section 1.664-3(a)(1)(c) goes even one step further and permits an income exception trust to convert, at a later date, to a straight income trust. These regulations show that there are instances in which charitable trusts, containing appropriate language, may refrain from paying a 5% unitrust amount in some years.

Furthermore, recognizing that calculation of the payout amount may, as a practical matter, not always be completed by December 31 of each year, the IRS does permit some unitrusts and annuity trusts to delay payment until the due date of Form 5227 (April 15 of the following year).[7] The IRS had originally taken a much more rigid stance, fearing that by delaying payment the taxpayer could, under the tier rules, turn a payment

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1 There was unsupported testimony that checks were issued but were uncashed.

2 The Trustee initially resisted the beneficiary's claim but the parties eventually reached a settlement.

3 S. Rept. 91-552 (1969), 1969-3 C.B. 423, 481.

4 1982-2 C.B. 71.

5 1989-1 C.B. 842.

6 1990-1 C.B. 539.

7 *See* Reg. § 1.664-2(a)(1)(i) and Reg. § 1.664-3(a)(1)(i).

of taxable ordinary income into a non-taxable payment from corpus. The regulations therefore provide that the delay cannot be used to shift the recognition of income past the year when it was due.

The IRS has also provided for annual taxation of the required unitrust distributions even when they are not made within the trust's taxable year. Regulation section 1.664-1(d)(4)(i) provides for the inclusion in income for the year in which the distribution is required to be made, even if actually distributed at a later date.

One would have hoped, then, that the Service would look favorably on the Atkinson trust if the trustee had carried an account payable on the trust books and paid the accrued annuity amounts to the grantor's estate upon her death.[8] But, alas, such hope was in vain. The Service followed the pronouncement in regulation section 1.664-1(a)(4), which requires that a CRAT function exclusively as a charitable remainder trust from its creation. This position, on first blush, seems not only harsh, but even draconian.

The Tax Court also appeared concerned that the secondary beneficiaries could have succeeded to the forgone payments. Aggressive tax planning and administration did, at one time, use net income unitrusts with a make-up provision as a means of passing tax-free gifts to secondary beneficiaries. Donor would create a CRUT requiring a unitrust payout of, say, the lesser of 7% of the annual net asset value of the trust or net income, for donor's life followed by the same unitrust payout for the life of donor's child. The instrument would also provide that in any year in which net income exceeded 7% any shortfalls for years in which net income was less than 7% would be made up to the extent of net income for that year. The gift to the child would be reported as the value of the trust less the value of the remainder to charity and less the value of the 7% unitrust amount retained by the donor. In fact, however, the trust would be invested strictly in growth assets during the donor's life and strictly for income after the donor's death and during the life of the child. The annual payment that the donor should have received would actually end up in the hands of the child. This scheme has been shut down by regulation section 25.2702-1(c)(3), which values the donor's retained interest in a net income make-up trust at zero unless either the donor's interest is the secondary interest, or the only income beneficiaries are the donor and/or the donor's spouse (who is a U.S. citizen.) But, that regulation is effective on May 19, 1997 and did not apply to the Atkinson trust.

There may be different results depending upon whether the trust is an annuity trust or a unitrust. Annuity trusts (the Atkinson trust is an annuity trust) may not accept additional contributions. Additional contributions to an annuity trust would result in lowering the payout amount as a percentage of total contributions. Also, since the annuity is fixed when the trust is created, the annual payout on the additional contribution, itself, would be zero, and flunk the 5% test. Unless the forgone payments are not treated as additional contributions and are returned to the initial annuitant with interest, this logic would apply to disqualify the annuity trust. This is not the case with unitrusts. Forgoing the unitrust payment also serves to increase the net asset value of the trust and thus future unitrust payouts. But unitrusts may accept additional contributions provided the instrument not only permits them, but also provides for a proration of the unitrust amount to account for the additional contributions.[9] Most unitrust documents are drafted with such language. Had the Atkinson trust been a unitrust, the proper solution to the problem, then, might have been to tax the donor on the constructive receipt of the unitrust amounts in the year when they were due, and to treat the failure to take such payments as additional gifts to the trust, subject to the gift tax and qualifying for charitable deductions for both income tax and gift tax purposes. But it is not absolutely clear that the Tax Court would have taken that approach with regard to unitrusts. Furthermore, the IRS would most probably insist on contemporaneous documentation of the decision to make the additional gift. The prudent practitioner, with respect to both annuity trusts and unitrusts, will, then, follow the exact terms of the regulations and the documents, and insure that all unitrust or annuity payments that are required to be made are actually paid, and paid in a timely manner.[10]

Atkinson is a clear warning to practitioners and trustees that it is not sufficient just to recite qualifying language. One must also administer charitable trusts in conformance with their governing instruments. ■

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8 The accrued income due was, in fact, included as an asset of the decedent's estate.

9 Reg. § 1.664-3(b).

10 What if the overly cautious trustee pays the unitrust amount or annuity early? Conrad Teitell raises two additional problems. First, since early payment actually increases the actuarial value of the income interest, should this cause the trust to fail to qualify for the charitable deduction? Second, the increase in the actuarial value of the income interest may even cause the trust to fail the 10% minimum remainder test or the 5% probability test of Revenue Ruling 77-374. We would hope that the IRS and the courts would apply a facts and circumstances test. Conrad Teitell, "Imperfectly Operated Charitable Remainder Annuity Trust Disqualified", Charitable Giving Newsletter, August 24, 2000.

SPECIAL REPORT: THE IMPORTANCE OF GST EXEMPTION ALLOCATIONS ON GIFT TAX RETURNS FOR LIFETIME TRANSFERS TO TRUSTS

by Stuart A. Rader, Boca Raton, Florida

Properly allocating the generation skipping transfer tax ("GST") exemption for lifetime transfers to trusts requires careful attention to the trust document and knowledge of the GST law and regulations. Failing to make timely and proper allocations of the GST exemption for certain lifetime gifts to trusts can often frustrate the client's estate planning goals of maximizing the use of the exemption and minimizing transfer taxes on future distributions from the trust.

GST is an additional tax (imposed at the rate of 55%) for generation skipping transfers that are subject to gift taxes in the case of lifetime transfers and estate taxes in the case of transfers at the time of death. An individual has a current exemption of $1,030,000[1] from GST. This exemption allows assets to pass from grandparents to grandchildren without the requiring the children (the intermediate generation) to pay estate or gift taxes on the transfer.[2] The exemption, when utilized properly by a grandparent, has the potential to save families over $550,000 in estate taxes upon death if a child/parent is in the 55% estate tax bracket.

As explained further below, whether a transfer to a trust requires allocation of the GST exemption on the gift tax return depends upon whether the gift is deemed a *direct skip* or a transfer to a *non-skip person*. Understanding the statutory definitions as interpreted by the Treasury regulations is imperative to making a proper GST allocation. Generally, a trust is a *skip person* if all interests in the trust are held by *skip* persons.[3] An individual is a *skip person* who is two or more generations below the transferor. Transfers to trusts with *skip* and *non-skip* persons are tested at the entity level and therefore are non-skip persons.[4]

Maintaining a zero inclusion ratio is key to allocating the GST exemption for lifetime transfers. The inclusion ratio is defined as the difference between one and the applicable fraction.[5] The applicable fraction is the amount of GST exemption allocated to a transfer to a trust or a direct skip divided by the value of the property transferred.[6] A zero inclusion ratio is obtained if the amount of exemption allocated (the applicable fraction numerator) equals the value of the property transferred (the applicable fraction denominator). For instance, if $100,000 in cash is transferred to a *non-skip* person trust and the transferor has not previously used the GST exemption, then a zero inclusion ratio is reportable on a timely filed gift tax return computed as follows: 1 - ($100,000/$100,000).[7] Generally, so long as timely allocations are made for *non-skip* person trusts, a trust will maintain a zero inclusion ratio provided that the aggregate value of transfers to the trust does not exceed the available exemption. If transfers to a *non-skip* person trust exceed the exemption, then, in the absence of splitting the trust into separate shares, one with an inclusion ratio of zero, and one with an inclusion ratio of one, the inclusion ratio will be greater than zero, resulting in a GST event on distribution to a *skip* person.

Example. A grantor funds a trust for children and grandchildren with $1,530,000 in December, 2000. A timely filed gift tax return is filed in April 2001, which allocates the grantor's entire exemption ($1,030,000) to the trust. The inclusion ratio is .3268 (1-1,030,000/1,530,000). In December 2001, a $100,000 distribution is made from the trust to a skip person.

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1 Section 2631. This amount is adjusted for inflation in $10,000 increments.

2 Frequently, generation skipping transfers are set up with split interest irrevocable trusts, wherein the children are discretionary or mandatory income beneficiaries who also may be entitled to principal subject to an ascertainable standard (for their health, education, support and maintenance), and the grandchildren are permissible principal beneficiaries and the remaindermen. The grandchildren may also be discretionary beneficiaries during their parent's lifetimes. Further, great-grandchildren may also be beneficiaries, creating another generational layer of tax benefits.

3 Section 2613(a)(2).

4 *See* Reg. § 26.2612-1 for further explanation and examples.

5 Section 2642(a)(1). Mathematically stated the inclusion ratio = (1 - applicable fraction).

6 Section 2642(a)(2). If applicable, the denominator of the applicable fraction is reduced by any federal estate tax and state death tax attributable to, and recovered from, the property and any estate or gift tax charitable deduction allowed with respect to the property.

7 Any future appreciation of the trust's assets will not be subject to the GST upon distributions to skip persons, so long as the inclusion ratio remains zero.

There is a GST payable on this distribution (.3268 (inclusion ratio) x $100,000 (distribution) x .55 (tax rate)).

In order to prepare a gift tax return with proper GST exemption allocations for lifetime transfers to irrevocable trusts,[8] practitioners need more than a basic understanding of the GST. What follows explains the reasons for this need and some of the issues involved.

NO PARITY WITH GIFT TAX ANNUAL EXCLUSION

Since 1988, the $10,000 annual exclusion from the GST has been much narrower than the annual gift tax exclusion.[9] The GST annual exclusion for transfers to trusts, found at section 2642(c), is limited to trusts with a sole *skip person* beneficiary. Eligibility for the GST annual exclusion also requires that, during the beneficiary's life, no portion of the corpus or income may be distributed to anyone other than the beneficiary, and that the trust will be included in the beneficiary's estate if the trust does not terminate before his death. Thus, a trust that qualifies for the GST annual exclusion will also qualify for the gift tax annual exclusion, but not vice versa.

A *Crummey* trust with one beneficiary may be drafted to qualify for the GST annual exclusion, but a *Crummey* trust with more than one beneficiary does not satisfy the above requirements (although transfers to it, may, in part, qualify for the gift tax annual exclusion). Accordingly, many transfers to trusts with more than one beneficiary may be excluded from gift taxes, but will not be exempt from GST. Transfers to such trusts require allocating the GST exemption on a gift tax return.

ALLOCATING EXEMPTIONS AND GIFT TAX RETURN REQUIREMENTS

Generally, in the case of *direct skips*, the GST exemption is automatically allocated to transferred property, first to achieve a zero inclusion ratio.[10] In the absence of gift splitting, allocating the GST exemption is not required on a gift tax return.[11] However, most tax preparers allocate for *direct skips* so that there is a clear record of the lifetime exemption used. Importantly, a late filed gift tax return for previous *direct skip* transfers uses the date of transfer values.[12]

Allocation problems most frequently occur with lifetime transfers to trusts that are *non-skip persons*, but have some beneficiaries who are *skip persons*. Regulation section 26.2632-1(b)(2) requires allocation of the exemption on a gift tax return. The return must clearly identify all of the following:[13]

- the trust to which the allocation is made,
- the amount of GST exemption that is allocated, which can be expressed by formula,
- the value of the trust assets at the effective date of the allocation when allocation is late (on a non-timely filed return, including extensions) or an inclusion ration greater than zero is claimed, and
- the inclusion ratio of the trust after the allocation.

With respect to a timely allocation for trusts that are not *skip persons*, an allocation of the GST exemption becomes irrevocable after the due date of the return.[14] Late allocations on non-timely filed returns are irrevocable, upon filing.

Although it would seem reasonable for gifts to a trust with *skip* and *non-skip persons* who have *Crummey* withdrawal rights as beneficiaries to be *direct skips* as to the *skip person* beneficiaries because of the current right to withdraw the money, the December 1995 Treasury Regulations make it clear that these transfers are *not direct skips*. Regulation section 26.2612-1(f), Example 3, provides as follows.

T transfers $50,000 to a new trust providing that trust income is to be paid to T's child, C, for life and, on C's death, the trust principal is to be paid to T's descendants. Under the terms of the trust, T grants four grandchildren the right to withdraw $10,000 from the trust for a 60 day period following the transfer. Since C, who is not a skip person, has an interest in the trust, the trust is not a skip person. T's transfer to the trust is not a *direct skip*.[15]

LATE ALLOCATIONS FOR NON SKIP PERSON TRUSTS

Late allocations (after due date, including extension) for transfers other than *direct skips* must be made at the value of the property at the time of allocation, including any and all post-gift appreciation (or depreciation) after the transfer date.[16] For example, if a marketable security was transferred to a trust for the benefit of

8 All references to trusts mean irrevocable trusts which receive completed gifts.

9 Section 2503(b).

10 One, however, may elect out of the automatic allocation to direct skips on a timely filed gift tax return specifying that the automatic election does not apply. Reg. § 26.2632-1(b)(1).

11 Reg. § 26.2632-1(b)(1)(ii).

12 Reg. § 26.2632-1(b)(2)(iii).

13 This information is normally set forth on a "Notice of Allocation" attached to the Gift Tax Return and referred to at Schedule C, Part 2, Item 5 of Form 709.

14 Reg § 26.2632-1(b)(2).

15 *See also* Treas. Dec. 8644, 12/26/1995 (enacting temporary and final GST regulations effective December 27, 1995) *But see* PLR 8901004, where the Service ruled that *Crummey* withdrawal rights to grandchildren in a trust where children and grandchild held *Crummey* powers were a direct skip to the grandchild and not a transfer to the trust. This private letter ruling is no longer valid authority for transfers after December 1995, but may be of some help for late allocations for transfers prior to the regulations.

16 Reg. § 26.2632-1(b)(2).

children and grandchildren and its value at the time of transfer was $250,000, then $250,000 of exemption should be allocated on a timely filed gift tax return. Assume that a gift tax return was not timely filed, that three years later, the stock had a value of $1,000,000, and that a gift tax return was filed at that time. At the time of the late filing, $1,000,000[17] of exemption must be allocated. The result is wasting $750,000 of GST exemption.

What if a trustee of a *non-skip* person trust with no prior GST allocations makes a transfer to a *skip* person at the time of a late allocation? Is the GST imposed on that taxable distribution computed before or after the late allocation? The late allocation is *deemed* to occur prior to the distribution, as demonstrated by the example found at regulation section 26.2632-1(b)(2)(iii).

In the example, T transfers $100,000 to a generation-skipping trust on December 1, 1996, in a transfer that is not a direct skip. T does not make an allocation of the GST exemption on a timely-filed Form 709. On July 1, 1997, the trustee makes a taxable distribution from the trust to T's grandchild in the amount of $30,000. Immediately prior to the distribution, the value of the trust assets was $150,000. On the same date, T allocates the GST exemption to the trust in the amount of $50,000. The allocation of GST exemption on the date of the transfer is treated as preceding in point of time the taxable distribution. At the time of the GST, the trust has an inclusion ratio of .6667 (1 - (50,000/150,000)).

The $30,000 distribution to the grandchild resulted in GST of $11,000.55 computed as follows: .6667 (inclusion ratio) x $30,000 (distribution) x .55 (tax rate).[18]

LATE ALLOCATIONS WITH DECREASE IN VALUE SINCE FUNDING

With the recent downward trend in the stock market, trustees may want to make late GST allocations for trusts holding marketable securities that have decreased in value since funding. The late allocation will have the unintended but favorable result of less of the exemption being utilized than was originally contemplated. Assume that X shares of a marketable security worth $1,000,000 were transferred to a trust for the benefit of children and grandchildren. Assume that a gift tax return was not timely filed and that, three years later, the stock had a value of $250,000 at which time a gift tax return was filed. At the time of the late filing, $250,000 of the GST exemption was allocated. Unlike the earlier example, the result here is to preserve $750,000 of GST exemption rather than to waste the same amount.

IRREVOCABLE LIFE INSURANCE TRUSTS ("ILITS")

An ILIT which is not a *skip* person because the beneficiaries are *skip* and *non-skip* persons offers an opportunity to leverage the GST exemption. The reason is that, if timely filed gift tax returns with proper GST allocations are filed for each year of the trust, *then only the premium equivalents gifted to the trust are allocated* to the GST exemption. Upon the death of the insured grantor, the death benefits pass to the ILIT trustee, without further GST allocation or consequences, even if the death benefits are greater than the grantor's remaining GST exemption available at the time of death.

If, for example, there is a $1,000,000 life insurance policy in an ILIT, the premiums are $50,000 per year, the insured dies in year three after "gifting premium equivalents" of $150,000 to the trustee, and timely filed gift tax returns allocated $50,000 per year, then the grantor/insured's GST exemption was reduced only by $150,000, the potential remaining exemption is $880,000, and the $1,000,000 death benefit passes to the trustee free from any present or future GST. Accordingly, there is a 6.6 leverage factor between the $1,000,000 life insurance death benefit passing to the ILIT trustee and the $150,000 GST exemption allocated. However, if gift tax returns were not timely filed, then the entire $1,000,000 is subject to GST and if the exemption were applied at death, then the death benefits would consume almost the entire exemption.

CONCLUSION

Proper and timely allocation of the GST exemption on a gift tax return is very important. Failing to do so may thwart a client's estate plan and could expose the tax preparer to damages for professional negligence. Allocation errors can be very expensive and usually can be avoided if the tax attorney is involved throughout the planning process and establishes clear guidelines for the annual gift tax return filings. The cost of the preparation of a timely and properly prepared gift tax return setting forth the GST exemption allocations is a very small expense when compared to the potential liability for the failure to allocate properly. ■

17 For practical reasons, valuation at the first day of the month of the late allocation may be used. Reg. § 26.2642-2(a)(2) (but this rule does not apply to the value of a life insurance policy held by the trust, if the individual insured died).

18 The tax relief provided by the deemed allocation prior to the taxable distribution is significant. If the rule did not exist, then the inclusion ration would have been 1 and the GST on the taxable distribution would have been $16,5000 computed as follows: 1 (inclusion ratio) x $30,000 (distribution) x .55 (tax rate).

POINT & COUNTERPOINT: TAX POLICY AND POLITICS

INTRODUCTION: We as a nation have just finished a presidential campaign in which tax proposals received prominent attention. Both candidates' proposals were criticized for representing a response to interest group pressure rather than disinterested policy. In a bit of a departure from the usual Point/Counterpoint format, we have asked four tax professors—Jim Maule of Villanova, Alan Gunn of Notre Dame, George Yin of University of Virginia, and Marty McMahon of University of Florida—to step back from the immediate political fray and to consider more generally the tension between tax and politics. To focus their comments, we have asked each to respond to the following proposition:

"Political concerns, rather than tax policy concerns, now lie at the root of tax legislation."

JAMES EDWARD MAULE

Villanova, PA

People like to complain about taxes. They complain about having to pay them. They complain that the rules are too complex. They complain that the law makes no sense. They complain that their tax burden exceeds everyone else's. These are not the bleatings of irrational idealists. They are the cries of tax practitioners, tax students, tax professors, and taxpayers.

At one time, the complexity and inequity in the tax law were attributed to tax policy. Now the proliferation of tax expenditures, exceptions to exceptions, targeted credits, specialized deductions, cascading definitions, bubbled tax rates, and the swamping of the Code with disguised appropriations provisions suggests that much of the morass that is the tax law is the product of electoral politics. Hence the proposition is one with which I whole-heartedly agree.

Though I agree with the proposition, I hesitate to cast blame. Fixing blame doesn't provide a solution. The situation is not the fault of any one individual, any one committee, any one organization, any one political party, or any particular segment of the public. It is, instead, the product of a cultural breakdown in the problem-solving process, an erosion of methodical, structured, organized, and razor-sharp precision thinking, and an abandonment of sweeping perspectives in favor of soundbite-sized, narrow tax tidbits. Equally, it is a tribute to diminished societal common sense and a widening of the chasm between practical and theoretical.

Tax policy concerns differ from political policy concerns. Tax policy is a question of ascertaining the most appropriate manner to raise revenue. To some, it also involves the matter of shifting resources from one sector of society to another. Tax policy requires an examination of progressivity, horizontal and vertical equity, administrability, and economic efficiency. Political policy is a question of acquiring votes by inserting spending provisions in revenue legislation in the form of credits and deductions targeted to identified segments of the electorate.

Although both tax policy and political policy involve issues of civic responsibility, political policy concerns contaminate the tax law with partisanship and its consequences. It is one thing to engage in partisan debate concerning the level of tax rates. In that instance, the outcome is simply a change in percentage rates. It does not cause the creation of a tax-favored class whose members are identified not by income level but by social behavior. It is another thing to hide government expenditures favoring targeted groups in the tax code. That is a political ploy that makes it less likely citizens can identify targeted spending.

In recent years it has become common practice for the Congress, no matter which political party is in control and no matter who lives 16 blocks up Pennsylvania Avenue, to stuff the tax law with all sorts of "goodies" designed to entice voters to select one candidate over another, or as "rewards" to fulfill campaign promises to some extent. Too often, the provisions are hastily drafted, receive cursory review, undergo chopping and interlineation, conflict with other Code sections, and require the impossible compliance and record-keeping efforts by taxpayers and their advisors. Lost in this ad hoc, me-first process is the long-lost art of stepping back and looking at what the big picture would be if the provision were enacted and evaluating the impact of the provision on the fabric of the tax law. New terms are invented. Terms that had one definition are given a second, and different, definition. Patterns of Code drafting that worked well are abandoned, not so much intentionally as through inadvertence and ignorance of their existence. As a result of this fragmented approach to tax legislation, there no longer is a coherent, consistent, and sensibly structured tax policy reflecting itself in the Code. Is it any wonder that the Code now fills 2,840 pages? Why are there several different definitions of "small business"? Why are some numbers adjusted for inflation and others left alone? Why are there dozens of

uncoordinated provisions each trumpeted by its sponsors as the tide-turning solution to the challenge of financing and improving education?

Because many taxpayers generally dislike the shifting of resources by the government, at least when the shifting isn't limited to other people's resources, and resist raising revenue to fund “government services” that are activities in which they feel the government ought not be involved, most legislatures would be voted out if they enacted or increased taxes straight up. So taxes get packaged, re-labeled, irradiated, sprayed with quick-freshener, bundled, and hyped. Magically, a tax increase is a tax cut. A spending increase is a tax cut. A tax cut is a disguised tax increase. A tax on one group is described as a tax on some other group. Superficially, everyone ends up concluding their taxes are being cut. Of course, tax revenue increases. Divide and conquer.

The few who really see through all of this either learn the “game” and use it for the benefit of their clients or learn the “game” and try to outlaw it through their teaching, public service activities, and other civic endeavors. What emerges from this political double-speak is a tax code that encourages the marketing of “products” designed to bring taxpayers within one or more of the hundreds of targeted tax breaks even though they don't otherwise qualify. Taxpayers are induced to engage in activities in which they would not otherwise participate, to do business in ways they would not otherwise operate, and to manufacture transactions that border on the abusive, fraudulent, and even criminal.

None of this makes good public policy, let alone good tax policy. The Treasury becomes saddled with the responsibility of bailing out the Congress by resolving the problems created by the omissions, ambiguities, inconsistencies, and nonsensical language peppering the Code. Is it any wonder that the there now are 46,000 pages of tax rules and regulations?

To reverse the trend requires widespread public acknowledgment that it is time to say goodbye, coherently, carefully, gracefully, elegantly, compassionately, and sensibly, to the present tax world. A tax system for the 21st century is needed. At the moment, the specifics of that new system are not as important as finding a strategy that sensitizes the electorate to the importance of a coherent revenue policy. Genuine tax reform must find its way into the public limelight and thus onto the politicians' radar screens. Recent polls suggest that most citizens don't care much about the issue. Gasoline and heating oil price increases get more attention and cause more publicized pain than does the prospect of 435 new credits, 500 additional forms, and 250-page tax returns. Until the media makes tax reform its darling, the policy of politics will continue to overshadow the tax legislative process and suffocate attempts to consider issues of equity, administrability, and economic efficiency. A daunting task awaits those who wish to engage citizens and politicians in a thoughtful reconsideration and thorough analysis of the tax law when existing law and its deficiencies cannot be encapsulated in a sound-bite, wrapped into a generalization, or packaged in simplistic buzz-words. Here's hoping it happens.

ALAN GUNN

Notre Dame, IN

The tax system has always reflected both policy and politics, but since 1986 the balance has shifted sharply toward politics. This statement can't be proven—one person's obvious political giveaway is another's sound policy. (I have heard an energetic defense of the poultry poop tax credit—not on the merits, but on the ground that, as an “environmental” measure, it must be good.) Without getting into the merits of the many subsidies that now litter the Code, I shall argue that politics now dominates policy by pointing to several features of the Code that can be explained only on crass political grounds.

First, the rate structure. A decent tax system would tell people in a straightforward way how much more tax they would owe if they earned an additional hundred dollars. Ours doesn't: the rates of section one are only a starting point. Itemized deductions are “phased out” (by a provision that in most cases operates without regard to the amount of the taxpayer's itemized deductions); additional income will raise many people's taxes (sometimes by more than the amount of the additional income) because their personal exemptions are phased out; and a host of other phaseouts make nonsense of the rates so simply set forth in section one.

Second, the alternative minimum tax. Advertised as a measure to limit the use of loopholes, this tax now operates principally as a tax on those with many dependents and with lots of itemized deductions. With the repeal of the AMT rule for charitable contributions of appreciated property, this tax has become a sham, falling most heavily on those with heavy expenses that, for no good reason, are disallowed for AMT purposes.

Third, complexity. As just one example, consider the many tax-favored ways of “retirement” saving. Congress seems unable to resist adding new vehicles and tinkering with the old ones each year, while taxpayers are often unable to cope with the old ones. A few years ago, the Service checked a large number of universities for compliance with the rules of section 403(b) and found that none had gotten it right, yet 403(b) plans are about as simple as retirement savings vehicles go.

Finally, consider a measure that passed Congress almost unanimously (always a bad sign): the supposed “shift in the burden of proof” to the Government in tax cases. As the burden of proof shifts only for taxpayers who have already met it, this legislation is a fraud, adopted after an absurd set of hearings, the only apparent purpose of which was to encourage voters to blame their difficulties with the tax law on the

Service rather than on the legislators who created that law.

Is there any good news? Well, real estate tax shelters were pretty much done in 1986. Since then, we've had reams of new statutes, all adding to the complexity of the Code, none seriously attempting any "reform" except in narrow and highly technical areas. It's been a bad 14 years for tax policy.

GEORGE YIN

Charlottesville, VA

I disagree with this proposition because it erroneously suggests that there has been a sea change in the factors influencing tax legislation. Politics and policy have always played significant roles in the enactment of tax legislation and that fact continues to be true today. To be sure, the precise mix of the two elements varies somewhat from period to period, and tax policy considerations do not seem to be as strong an influence now as they were in the mid-1980's. But I am not persuaded that what we are seeing today represents any dramatic change from either that period or earlier times.

In contending that we have experienced a sharp shift towards politics since 1986, Professor Gunn raises several examples, which, I think, tend to support my view. The AMT features he criticizes as having little policy justification—the nondeductibility of itemized deductions and personal exemptions—came into the law in 1986 (or in a technical correction shortly thereafter), his peak year for good policy. The 1986 Act also included various phaseouts that obfuscated the true tax rate structure. Conversely, the key point regarding the burden of proof legislation is that it turned out to be, as Professor Gunn states, a "fraud." In other words, policy concerns ultimately prevailed over crass politics to prevent any meaningful change in that area.

Personalities certainly play a role in the relative importance of policy and politics but so do many other factors. The end of bracket creep and the large budget deficits persuaded lawmakers during the mid-1980's to raise taxes without raising rates (a political calculation). Many of the resulting base broadeners therefore served political goals as well as sound policy objectives. Later, the budgetary situation (and the public antipathy towards increased direct government spending) has forced lawmakers to use the tax code more for their spending initiatives. These changes seem part of the normal cycle of events influencing tax legislation.

Will policy make a rebound in the near future? A gloomy assessment is that the political deadlock will not permit it. Any tax legislation will be a product of naked political trades—one from column "D" and one from column "R"—with no sensible pattern from a policy standpoint. A much more optimistic view is that the competing political agendas will neutralize themselves, thus leaving the field wide open to good policy. The most likely scenario, barring any significant change in the economy, is that the stalemate will prevent major legislation altogether: we will see neither large tax cuts nor substantial spending increases (either directly or through the tax code), with the default being a reduction in the national debt. Could be worse.

MARTIN J. MCMAHON, JR.

Gainesville, FL

When I reflect on the nature of tax legislation since 1987, I often am tempted to succumb to the dreary conclusion that "tax policy" is dead. In the past few years neither the Republican Congress nor the Clinton administration has advanced proposals that I would consider to represent sound tax policy. Much of the legislation that has been enacted has undone the principles underlying the Tax Reform Act of 1986. The basic theme of the 1986 Act was to lower the rates while expanding the base to be more comprehensive. To be sure, the 1986 Act contained some political gimmickery, such as rate bubbles created by the section 67 floor on miscellaneous itemized deductions, the section 68 haircut on certain other itemized deductions, and the section 151(e) phase-out of personal exemptions. Any valid policy goals of those provisions largely could have been achieved through a greater number of statutory rate brackets. To do so, however, was not politically palatable, even when the top rates were increased in 1990 and again in 1993.

The tax legislative process now frequently appears to be little more than electoral politics played out in the pages of the Internal Revenue Code. Discussion and debate seem to focus more on the distributional impact of changes in base and additional tax credits than on the structural coherence of new legislation. General rules are disappearing under a welter of special rules. "Targeted tax cuts" wreak havoc with the tax system, adding inordinate complexity and rendering the determination of effective marginal tax rates an unsolvable mystery. If distribution of tax burdens across income classes is the real concern, it can, and should, be resolved primarily by changes in the rate schedule in section 1. But apart from the changes at the top end in 1990 and 1993, that has not been the route chosen.

Consider the new credits enacted in the past decade and a half. On the business side, there are the section 1396 empowerment zone credit, the section 44 disabled access credit, the section 43 enhanced oil recovery credit, and the section 51A welfare-to-work credit, not to mention significant tinkering with the section 41 increased research expenditures credit and the section 51 targeted jobs credit, renamed as the work opportunity credit. On the individual side, in the past six years alone we've added the section 24 child credit, the sec-

tion 23 credit for adoption expenses, the section 25A Hope scholarship and lifetime learning credits, and the section 1400C credit for District of Columbia home-buyers. These individual credits are piled on top of, or overlap with, the pre-existing credits under section 21 for child care expenses, the section 22 credit for elderly and disabled taxpayers, the section 25 home mortgage credit, and the much-modified, ever-increasingly complex section 32 EIC, a provision that not even the proverbial rocket scientist easily can understand and apply correctly, but which applies to those least able either to read rules themselves or to afford competent tax advice, and which, to boot, creates its own egregious rate bubble. (The section 25A education tax credits, furthermore, are but part of another web of poorly coordinated tax expenditures for education including Education IRAs and the section 135 exemption for U.S. Savings bond interest used to pay education expenses.) Much of this tangle of credits was brought to us by a Congress that paid lip service to simplicity while dedicated to cutting taxes in virtually any way possible, and an administration dedicated to social spending. Perhaps both Congress and the administration believed in the merits of their proposals, but the tenor of political campaigns over the past decade surely justifies some skepticism about the motives of both sides. When the administration dressed up its spending programs as tax cuts to get them through Congress, the inevitable result was chaos in the pages of the tax Code.

Finally, there is the capital gains saga, the never-ending story. The problem of how to tax, or not to tax, capital gains has a long lineage. As long as the rates are positive there will be a hue and cry from some quarter that one, or another, or all types of investment need, or are entitled to, some preference for one reason or another. There is nothing better than the capital gains debate, however, to illustrate that the Congress does not care carefully to analyze the actually anticipated economic effects of the tax rules or changes in the tax rules but would rather postulate effects that justify the particular politician's preconceived notion of who deserves a tax reduction or who should bear the burden of a tax increase. There are few provisions that compare to section 1(h), in all its glory, to inspire the question, “What policy?”

Reasonable people may differ on (1) the proper role of government in our society, (2) whether nonrevenue goals should be pursued through the tax system, and (3) who should benefit from government programs implemented through the tax system. All of the credits noted above, as well as the capital gains preference, are examples of this tension. These rules present tremendous complexity, but whenever government acts to deal with a perceived problem, someone gets overwhelmed with detail. Who gets overwhelmed is a matter of how government chooses to act. But as far as taxation is concerned, it's hard enough just to pick the right base, measure income if that is the base, choose the right taxable unit, and figure out how to deal with business entities, sophisticated financial instruments, and international transactions. These are crucial tax policy issues that, with the possible exception of the proper treatment of married couples—I refuse to use the “m------ p------” term because it's a loaded term designed to preordain the resolution—are not being adequately and comprehensively addressed at the legislative level, although there are occasional instances of legislative problem solving, such as the section 357(c) “fix” last year. But no one seems to care about the problem of the AMT trap disallowing a deduction for plaintiff's attorney's fees in taxable personal injury cases. Now that's a tax policy question. Thus it is easy to get frustrated with the never-ending parade of tax expenditure proposals from time to time and to conclude that there is no tax policy anymore, just politics.

On the other hand, many of the credits, for example, as well as other unenacted proposals, do reflect some policy choice, not necessarily tax policy, but some type of government policy, and it's just the packaging that is political. (Let us not forget that, in order to get it passed, Social Security originally was politically packaged as akin to saving through insurance, rather than acknowledged as an intergenerational income transfer program.) Any of us may or may not agree with any particular policy proposal, but that doesn't necessarily mean it's not some sort of policy proposal, even if it's environmental policy implemented through the tax system as, for example, tax-free transit passes. And we may disagree with the efficacy of particular provisions, such as the capital gains preference, but that doesn't necessarily mean that there was no policy, just politics. Maybe there was, maybe there wasn’t. Resolving this last issue is what public choice theory of the legislative process is all about. ■

INTERVIEW WITH RONALD A. PEARLMAN

by Jasper L. Cummings, Jr., Washington, DC, and Alan J.J. Swirski, Washington, DC

INTRODUCTION: On November 9, 2000, Jack Cummings and Alan Swirski interviewed Ronald A. Pearlman. He began his law practice in the Interpretative Division of the Office of Chief Counsel in 1965. After four years with Chief Counsel, he practiced law in St. Louis for 15 years. In 1983, he became Deputy Assistant Secretary for Tax Policy, and became Assistant Secretary in 1984. After another stint in private practice, Mr. Pearlman became Chief of Staff of the Joint Committee on Taxation in 1988. Mr. Pearlman is now a tax professor and director of the graduate tax program at the Georgetown University Law Center.

Q Many people consider the 1986 Code to be the high water mark of good tax writing in recent times. Do you agree, and how did that come about?

A I do agree; however, because I was so involved in Treasury's work on tax reform, I realize that I am biased. Certainly the legislation was not perfect. But, as the end product of an effort to fundamentally examine the income tax system and implement a broadened tax base with lower rates, I believe the Tax Reform Act of 1986 was very positive reform. Incidentally, Treasury I, the initial report to the President, even though 16 years old, remains relevant. Not only did it include a valuable discussion of basic tax policy principles and a detailed analysis of the income tax; it also included a summary of consumption tax alternatives and an in-depth analysis of the value-added tax. In fact, Treasury I gently suggested that as part of revenue-neutral legislation, some form of sales tax, such as a value-added tax, might be used to remove some of the pressure on the income tax. This suggestion from 1984 is a less-developed version of Professor Michael Graetz's more recent proposal to combine a value-added tax with a modified income tax.

The 1986 Act did not result from any single factor but, rather, from a confluence of factors. Strong leadership by the President, the two Secretaries of the Treasury, and the leadership of the tax-writing committees was very important. The fact that Secretary of the Treasury, Donald Regan, released Treasury I in spite of the controversial nature of many of the proposals was a very important early step. For any Treasury Secretary faced with an array of important fiscal issues to devote the time that Don Regan devoted to the development of Treasury I and then to stand behind the report following its release is quite impressive. Obviously, following the release of Treasury I, the President could have killed it. We used to speculate that if we were to send Treasury I to the White House in the morning, it might come flying back over the fence in the afternoon. I think there are two reasons that it did not. First, Jim Baker had replaced Don Regan as Treasury Secretary shortly after the release of Treasury I. Although Secretary Baker had reservations about many of the Treasury I proposals, he understood the economic and political potential of tax reform. Thus, instead of killing the effort, he set out to develop a revised set of proposals. This effort resulted in the President's proposals to the Congress, sometimes referred to as Treasury II. The second reason tax reform did not die within the Administration was the interest of the President. We had a number of very interesting meetings on Treasury II with President Reagan during the spring of 1985. We reviewed all of the important proposals with him and engaged in substantive discussions with him on many of them. I was taken by his interest in the specifics during those discussions and the considerable political courage he subsequently displayed by approving proposals that we knew would be very controversial. Credit also has to go to Dan Rostenkowski. He demonstrated his commitment to tax reform through his willingness to start the deliberative process in the Ways and Means Committee after the President released Treasury II and by resuscitating the proposed legislation following a critical committee vote on bank debt reserves during markup. I left Treasury following approval of the tax reform legislation by the House and, thus, had no direct involvement with Senator Packwood during deliberations in the Senate. But, it is clear from a review of the process in the Finance Committee that he too exhibited very strong leadership. I would be remiss if I did not comment on the extraordinary work, in my view historic work, by the various staffs. By recalling the quality of Treasury I, you can understand my abiding regard for the Office of Tax Policy staff and the IRS people who assisted us. The work of the Joint Committee, Ways and Means and Finance staffs under the intense pressure of the legislative environment also was outstanding. There were many individual efforts that led to a successful conclusion. Of course, there were other factors: the very serious individual tax shelter problem, publicity indicating that a

number of multinational corporations were paying no or very little U.S. tax, and the design of the legislation that resulted in substantial reductions in individual and corporate tax rates. When all is said and done, perhaps the stars just happened be properly aligned in a way that enabled passage of the 86 Act. It truly was an amazing time; no question about it.

I must add that working with Dan Rostenkowski during my time in government was particularly memorable. I had a number of wonderful experiences with him, but I always will particularly remember a brief incident relating to tax reform. I am not certain of the date. I think it must have been during the fall of 1984, shortly after Treasury I had been released. I attended a Ways and Means Committee markup on a relatively minor tax bill. For some reason, the markup was held in H-208, the Ways and Means Committee caucus room in the Capitol. The room is very small and, on that day, it was crowded with Members, staff and the press. I had a somewhat tense exchange with the Chairman over a provision in the pending legislation that the Administration opposed. Of course, he won and I lost. Near the end of the conference, the Chairman's staff director told me that the Chairman wanted to see me after the markup in the small anteroom at the rear of the caucus room. Now, picture this anteroom. I think it was nothing more than a converted hallway, perhaps four or five feet wide, with doors on each end. There was virtually no furniture; the space was too narrow. The primary seating was a padded bench along one wall. I walked in, sat down on the bench, and waited for the caucus room to clear. Shortly thereafter, the Chairman came in and closed both doors. All that I could remember at the time was our earlier verbal exchange. Rostenkowski is considerably taller than I and is quite an imposing figure. At that moment, he appeared to be about eight feet tall. I anticipated receiving the wrath of the leader of a powerful House committee for having objected to the pending Committee action. Instead, he sat on the bench next to me and said, in effect, *"You don't realize what tax reform is going to be like on the Hill. You don't know how contentious and how pressure-packed the process is going to be. I just want to let you know there are times when I won't be able to help you. But, if I can, I will. If you need help, tell me."* And that was that. Two minutes and it was over. Throughout the summer and fall of 1985, as we participated in a very contentious process in the House, I recalled that brief encounter with the Chairman in the H-208 anteroom. There I was, a Treasury representative in a Republican administration listening to the Chairman of the Ways and Means Committee in a House of Representatives controlled by the Democrats say, "Trust me; if we can do the right thing—if we can achieve the proper tax policy—we will."

Q You served as Chief of Staff of the Joint Committee on Taxation from 1988 through 1990. Would you describe for us the interrelationship between the JCT, the House and the Senate tax writing committees, and the Treasury?

A Relationships vary. At the Joint Committee, relationships with Members of Congress and the other staffs depend particularly on the personalities of the chairmen and ranking members of the tax-writing committees, relationships among the committee members, and the relationships between the House and Senate and between the Congress and the Administration. Of course, the personalities of the individual staff members were important. On the whole, during my tenure, I think the Joint Committee enjoyed very cordial relations with members of the Finance and Ways and Means Committees and their staffs. Everyone had a job to do, and each staff brought considerable value to the process. My impression is that Members, their personal staffs, and the Ways and Means and Finance staffs value the substantial expertise of the Joint Committee staff. As you know, most members of the Joint Committee staff have been around for quite a long time. As a result, they have substantial legislative experience and an invaluable collective institutional memory. They know how to analyze substantive issues and draft legislation and supporting documentation in very demanding circumstances. On the Hill, even though the various staffs represent different constituencies and, on occasion are required to take different positions, we rarely viewed ourselves as totally separate. Indeed, if an outsider were to join a typical meeting of the various staffs, most of the time it would have been impossible to determine who was on what staff.

Relationships between Treasury and the Joint Committee also have varied. When I was at Treasury, we had a very good relationship with the Joint Committee staff. For example, our revenue estimators interacted with the Joint Committee revenue estimators on their own without anyone else being involved. The two staffs did not always reach the same conclusion, but David Brockway and I thought it was important for all of the estimators to have access to the most current data and to be able to discuss the relevant theoretical issues without interference from others who might have specific policy objectives. Regular and cordial interaction between the Treasury and the Joint Committee and tax-writing committee lawyers also was the norm. Treasury participated in drafting sessions, and I think we were included in most caucuses and other Member meetings. To my knowledge, we always were included in markup sessions and in House-Senate conferences. Unfortunately, unfettered interaction between Treasury and the Hill is not always possible. While I was a member of the Joint Committee staff, there were occa-

sions when Treasury was excluded from drafting sessions and certain Member meetings, including meetings between the Ways and Means and Finance Chairmen during conferences on bills. This situation did not accurately reflect the personal relationships or professional respect among the Hill and Treasury staffs. Rather, it simply was a time when the political relationships between the Democrats in Congress and the Administration were somewhat strained, and, unfortunately, broader politics interfered. To my knowledge, most of the time, the Treasury and Hill staffs are able to work together by staying out of the political fray.

Q What Code provisions, other than the '86 Tax Reform, generally, that were passed on your watch do you consider to be good examples of "tax reform" that have worked out well in practice?

A It is hard for me to respond to your question without mentioning the broad reforms of the 86 Act, such as base broadening, but I will mention a few specific provisions, including some from 1986.

I think the Section 382 net operating loss legislation was good tax reform that has worked out reasonably well in practice. The section is very complex, perhaps unduly so, but it addresses important tax policy issues involving the proper utilization of net operating losses. I probably am one of very few who think the uniform capitalization rules are good tax reform since they represent an important contribution to the goal of more accurately measuring business income. After an initial period of adjustment, I think they too have worked out reasonably well in practice. I arrived at the Joint Committee shortly after the enactment of Section 2036(c), the estate freeze rule, and it was under fire. I lived through the period when full repeal seemed to be a real possibility. To the credit of the various tax staffs, and particularly to Mel Thomas of the Joint Committee staff, we were able to develop a set of fallback proposals that was not perfect but that I believe was an improvement over the pre-Section 2036(c) law. Finally, let's not forget the tremendous impact that reduction in individual income tax rates coupled with the reintroduction of the standard deduction and increases in the personal and dependent exemptions in 1986 had on the fairness and simplification of the tax system for millions of lower and middle income taxpayers. Those of us who tend to focus on business tax issues sometimes forget the importance of individual tax reform.

Q Do you consider the influence of "special interests" in tax legislation to have increased or remained the same over the last 20 years, and how has it changed?

A It seems as though the influence of special interests has increased over the past 20 years, but I am not certain the perception is accurate. One of the topics on my research agenda, which I hope to get to as soon as I am a couple of weeks ahead of my students, is to go examine more carefully how the legislative process has changed. I am particularly interested in examining the Wilbur Mills and Russell Long eras to see whether our memory of a better tax legislative process during those earlier years is accurate. Something tells me that upon closer examination, we might find that the special interests were alive and well in those bygone days and that the "sausage factory" was as messy then as it appears to be now. This was certainly the case 17 years ago, when I arrived at Treasury. I suspect the reason that we might consider the influence of special interests to have increased is that there is a more visible lobbying industry in Washington. There certainly are more well-trained, sophisticated tax lawyers involved in legislative activity, more sophisticated grass roots lobbying, and, of course, more substantial campaign financing. Do the special interests have greater influence? I am not certain that they do.

Q Do you foresee fundamental income tax reform in our lifetimes? To inform that question, do you see international or business changes as pushing the U.S. toward a fundamentally different type of tax system?

A The term "fundamental tax reform" carries some baggage, and so it is important to define it. If what you mean is the enactment of a consumption tax, I need to tell you a brief story. In 1984, during our work on Treasury I, I bet Secretary Regan five dollars that the United States would have a value added tax within five years. As you can see, my ability to predict even on the short-term, let alone in our lifetime, is not very good.

I prefer to think of fundamental tax reform more broadly, as an opportunity to examine seriously our tax system. I think such a reexamination is likely to occur in the not-too-distant future. The internationalization of business and the increasing mobility of people and capital undoubtedly will influence the debate. Even though maintaining an income tax in a global economy is challenging, particularly a tax on business income, I do not think the U.S. will reject the income tax entirely in favor of a consumption tax. I believe most Americans consider the income tax to be a fair way to finance the Federal government, and I doubt the electorate would agree to the explicit exemption of income from capital from tax. However, I also think we need to have a "pull the income tax out by its roots" public debate. Once we do, then if my prediction is accurate, we can proceed to a serious discussion of how to improve the income tax. I believe that discussion should include consideration of an additional revenue source, such as a value-added tax. The revenues from such a new tax might be used to lower income tax rates or increase the

present zero rate; provide relief from other troublesome provisions of present law and thereby take some pressure off of the income tax as suggested in Treasury I; or ease the regressivity of the employment taxes.

Q You have gone from legislative work to practice to teaching law and back and forth a couple of times. What valuable perspectives do practitioners and academics have to offer to the process of tax law writing and interpretation? Can think of any examples of an academic idea that has actually been implemented into an important piece of tax legislation?

A My wonderful colleague at Georgetown, Professor Martin Ginsburg, was one the important participants in both the subchapter S and installment sale legislation of the early 1980's. Although I do not want to understate Marty's skills as a practitioner, I understand that his contributions as an academic were quite significant in the development of that legislation.

Another example of academic influence is the work of Professor Daniel Halperin, formerly of Georgetown and presently of Harvard, on the theory of the time value of money. Tax policymakers have placed much more emphasis on time value of money principles since Professor Halperin began writing on this topic. In short, I believe that academics can have a huge impact on the development of tax policy by reason of the power of their intellect (yours truly excepted) and their ability to conceptualize without getting mired in the details of practice.

The practitioner's role in the legislative and interpretive processes also can be quite important. Practitioners are in the best position to accurately evaluate the impact of proposals in the real world—on real people and on real transactions. The challenge is for practitioners to define and make clear the role they seek to play when offering advice. I remember suggesting to the Tax Section leadership during development of the 1986 Act that we needed and sought the Section's input on how proposals would operate in practice in order that we might try to simplify and otherwise improve the technical quality of the legislation. In the same discussion, I said that we were working to implement policy decisions made by the President, and later by the Ways and Means Committee, and, thus were not particularly interested in having the Section's technical input tainted by its views on the merits of the policy decisions. During that time, those practitioners who understood the value of their technical input and were willing to put their policy views on hold had much greater influence. Some practitioners responded positively and constructively; others did not.

Q Do you think the "tax shelter problem" requires more and more tightly worded rules and regulations or does it require more and more vaguely worded anti-abuse rules?

A I consider the "tax shelter problem" as a two-tiered problem and as requiring both broad and narrow rules. At the "broad" level, I have long thought the marketing of a fair number of aggressive interpretations of the law is based either explicitly or implicitly on the audit lottery. To the extent I am correct, I believe the answer lies in increasing the likelihood of audit, among other things, through expanded disclosure. For several years the Tax Section to its credit has urged the Treasury and the Service to require such disclosure by regulation or other administrative action to the extent possible under present law. Both organizations deserve credit for their recent administrative activity. To the extent additional legislative authority for disclosure is needed, or if a more meaningful nondisclosure penalty is appropriate, as I believe may be the case, then Congress should act. It is hard for me to believe that taxpayers and their representatives can seriously quarrel with return disclosure, even if, for the sake of completeness, the rules require the disclosure of certain legitimate transactions, particularly if the penalty for nondisclosure is not linked to the accuracy related penalties. Why shouldn't a revenue agent have the opportunity to form her own view of a transaction?

Also at the "broad" level, I believe in anti-abuse rules, even though I recognize they may reduce transactional efficiency. Taxpayer confidence in our tax system is what sets the U.S. apart from many other countries. Anti-abuse rules cause taxpayers and their advisors to be somewhat more cautious when operating on the "cutting edge." I believe the law should encourage such caution. Thus, to the extent a legislative endorsement of a judicially developed anti-abuse rule, such as the economic substance doctrine, might cool the current tax shelter climate, I would consider such legislation appropriate. For example, I think a legislative confirmation of the economic substance doctrine could be crafted very broadly and in a manner that continues to leave the application of the doctrine to the courts. For example, I would encourage a single sentence of legislation stating simply that whenever a court determines that the economic sub-

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stance doctrine applies, the degree of economic substance must be meaningful. I would leave to the courts the determination of when the economic substance doctrine is applicable and what "degree of economic substance" means in particular circumstances. If this statement raises questions about particular transactions based on specific tax incentives, such as the low income housing credit, let the transactions be identified. Congress easily can provide protection if appropriate.

At a "narrow" level, there are instances in which more tightly worded rules also make sense. When the Service finds a loophole in the Code or an infirmity or ambiguity in a regulation that results in taxpayer responses which seem inconsistent with the sensible operation of the statute, a tightly worded statutory amendment or modification of the regulation might be all that is necessary to correct the problem. The recent Section 357(d) legislation, in my opinion, is a good example.

There is no simple answer to your question regarding broad or narrow rules or to the broader question of how government should respond to aggressive tax planning. Therefore, I do not think it is particularly productive to look for a magical one-shot solution. Taxpayers may be expected to take aggressive interpretative positions no matter what form of tax system is in place and no matter how specific or how general the law may be. It is the Internal Revenue Service's duty to analyze reported positions and seek to enforce fairly the law through administrative pronouncements, litigating positions, and the imposition of civil and criminal penalties when appropriate.

Should Treasury determine that the Service does not have sufficient statutory authority to stop an abusive transaction, it should promptly inform the Congress. Sometimes corrective legislation will be forthcoming, sometimes not. Too often I think Treasury waits too long before conceding that corrective legislation is necessary. The private sector also has an obligation—simply put, not to hide the ball. I am convinced that rules requiring full disclosure, providing the Service a reasonable opportunity to evaluate the merits of the taxpayer's reporting position, will have a dampening effect on tax shelter activity without precluding taxpayers from taking aggressive interpretative positions that they believe are defensible. ■

MEMBERS REACT TO **ABA JOURNAL ARTICLE**

FROM PAGE 7

expressed by the ABA. I would regret letting my membership lapse after 20 years."

"I would appreciate receiving your views."

Martha, I share Mr. Shaff's concerns about some of the positions the ABA adopts. In completing the annual survey on the ABA's legislative priorities, I found I do not agree with some of them as a policy matter, nor would I rate them as priorities. I fear that is a view shared by many ABA members. I know several attorneys who have resigned from the ABA over positions the ABA has adopted. I know others who remain members despite disagreement with ABA positions because they value their membership in one of the sections—and can ignore the rest of the ABA—or because they believe the best way to affect the organization's policies is to remain a member and work to change them.

I realize that control of the policies and priorities of the organization is not vested in you as President, but I would urge you to use your position to ensure that the views of the many members of the bar who do not agree with positions we know to be controversial are fully considered. I also urge you, in setting the ABA's legislative priorities for the coming year, to consider the addition to the list of issues of more general importance to the majority of Americans and with which there is much agreement. In considering legislative priorities, it is important to recognize that the fact that a position is of general interest and not controversial does not mean that necessary legislation will be enacted. Consequently, ABA support of such positions can be important. Were we to include even one such item in the list of legislative priorities, we would signal to dissatisfied ABA members that we are listening to them and addressing their concerns.

As significant, we would indicate to the public that the ABA understands and is willing to speak for the interests of all Americans.

Thank you for your consideration.

Warmest regards,
Pam Olson

2001 MAY MEETING: THE CHANGING BUSINESS ENVIRONMENT

MAY 10-12, WASHINGTON, DC

GENERAL INFORMATION

Washington, DC welcomes the Section of Taxation to the 2001 May Meeting, May 10 – 12th. Join us and take advantage of the opportunity to meet with the country's leading tax attorneys and government officials to discuss the latest federal tax policy initiatives, regulations, legislative forecasts, and planning ideas. The Grand Hyatt Washington will again serve as the Section of Taxation's Headquarters Hotel. In addition, a special block of rooms has been reserved at the nearby Marriott Metro Center.

BREAKFAST WITH COMMISSIONER ROSSOTTI

The Section is pleased to announce that Charles O. Rossotti, Commissioner of Internal Revenue, Washington, DC will be speaking to the members at breakfast during the May Meeting. All Section members are welcome to attend this complimentary breakfast that will be held on Friday, May 11th at the Grand Hyatt from 8:00 a.m. – 9:00 a.m. Although the breakfast will be complimentary, it will be a ticketed event and is listed on the registration and ticket order form. For planning purposes, please indicate your intention to attend on the registration form.

SCHEDULE CHANGES FOR FRIDAY COMMITTEE MEETINGS

Due to the breakfast with Commissioner Rossotti, the schedule for Friday Committee Meetings and Luncheons will change. Committee meetings and luncheons will start and end thirty (30) minutes later than their regularly scheduled times. The adjusted time schedule for Friday will appear in the *Preliminary Meeting Program* and on the website in late March.

DRESS CASUAL

The dress for the 2001 May Meeting is casual, so relax and leave those suits at home!

REGISTER AND QUALIFY FOR FREE AIRLINE TICKETS

At the May Meeting, the Section will raffle two airline tickets for travel within the continental United States. All registrations postmarked or faxed by Friday, April 13th will be eligible. The drawing will take place at the May Meeting Section Luncheon.

MEETING REGISTRATION FEE WAIVED

The Tax Section is pleased to be able to waive the 2001 May Meeting registration fee for Tax Section members who have never attended a Tax Section meeting and for law students and LL.M. candidates. Meeting benefits include continuing legal education programs, legal publications, professional development, networking and access to up-to-date information. To register, use the Meeting Registration form available in this *Newsletter.*

REGISTRATION INFO AND ADVANCE REGISTRATION DISCOUNT

Any Section member attending any part of the 2001 Midyear Meeting, whether or not he or she speaks, must register and pay the registration fee. Shared registrations are not permitted at this meeting. Companions are defined as non-Section members not attending substantive meetings. Any companion attending substantive programs must register and pay either the Section member or non-Section member registration fee, whichever is applicable.

The Section is pleased to offer a 15% discount to advance registrants. To register for the 2001 May Meeting, please use the Meeting Registration Form in this *Newsletter*. **The final deadline to receive the advance registration discount is Friday, April 13, 2001.**

The registration fee includes one set of meeting materials, and permits registrants to attend all meetings, sessions and programs; however, it does not include meal functions and social events listed as "Ticketed Event." You must be registered to purchase tickets. All tickets are sold on a first-come, first-served basis. Payment may be by check or credit card. The Section accepts American Express, MasterCard and VISA.

The Meeting Registration Form and full payment must be postmarked or faxed by Friday, April 13, 2001 in order for your name to appear on the Attendee List and to be eligible for the 15% discount and airline tickets raffle. Registrations received after this date will be processed as on-site registrations. **No registration form**

will be processed or considered received unless payment is received.

Registrations will be accepted in the Section office after the April 13th deadline; however they will be processed at the on-site registration rate. Those who register between April 13th and May 3rd may pick up their name badge and meeting materials at the "Advanced Registration Area."

REFUND POLICY

All cancellations and refund requests must be ***made in writing and*** postmarked or faxed by April 13th to receive a refund. All refund requests will incur a $50 cancellation fee. Absolutely no refunds will be granted at the Meeting. Direct all refund requests to the Meeting Registrar at the Section office.

HOTEL RESERVATIONS

The Grand Hyatt Washington will serve as the Headquarters Hotel for the May Meeting. A special block of rooms has been reserved at the Marriott Metro Center located within walking distance of the Grand Hyatt.

To make reservations for the Grand Hyatt or the Marriott Metro Center, please use the Hotel Reservation Form available in this *Newsletter*. **The deadline for making reservations is Friday, April 6th.** Attendees are strongly encouraged to make reservations early, as the hotels frequently sell out prior to the deadline and sleeping rooms are limited.

Please note that the Hotel Reservation Form should be sent directly to the hotels, not to the Section Office.

AIR TRAVEL INFORMATION

American, Delta and US Airways are the preferred airlines for the 2001 May Meeting. To make airline reservations or to compare rate information, attendees should contact the airlines directly. To make airline reservations or to compare rate information, attendees should contact the airlines directly using the ABA reference numbers provided below.

American Airlines **800/433-1790**
(Code: S13266)

Delta Airlines **800/241-6760**
(Code: 170346A)

US Airways **877/874-7687**
(Code: 21900057) **(toll free)**

Attendees are encouraged to compare all options available, including rates and restrictions between an airline's own zone fares and ABA rates. Assistance is available through your travel agent, directly from the airline, or from the ABA travel agency, Tower Travel Management at 800/921-9190.

CAR RENTAL INFORMATION

ABA Members can receive special rates through Hertz. Call 800/654-2230 and mention the ABA/Hertz CDP #13000; TDD users dial 800/654-2280. You will be asked for your ABA membership identification at the time of rental.

CHILD CARE SERVICES

If you need childcare services, contact the concierge at the Grand Hyatt. The hotel uses a bonded, licensed childcare agency.

CLE, CPE AND ETHICS CREDIT

Please note that you must be registered for the meeting in order to be eligible to receive CLE, CPE or Ethics credit. Accreditation will be requested for this meeting from every state with mandatory continuing legal education (MCLE) requirements for lawyers. Please be aware that each state has its own rules and regulations, including its definition of "CLE." Certificates of attendance will be available at the meeting for both attendees and speakers. Call 312/988-6217 for questions pertaining to the number of credit hours granted by each state.

The American Bar Association is registered with the National Association of State Boards of Accountancy as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses. Complaints regarding sponsors may be addressed to NASBA, 150 Fourth Avenue North, Suite 700, Nashville, TN 37219-2417. The ABA's sponsorship I.D. number is 103951.

SECTION LUNCHEON AND RECEPTION

The Section Reception is scheduled for Friday, May 11th at the Grand Hyatt. The Section Luncheon, sponsored by LEXIS-NEXIS®, will take place on Saturday, May 12th at the Grand Hyatt.

SECTION EXHIBIT

The Section of Taxation Exhibit will take place on Friday and Saturday. Representatives from a variety of tax publishers and service providers will demonstrate the latest tax law research methods and exciting new products to aid you in your daily practice.

MEETING MATERIALS

The Section Program Meeting Materials will be available at the May Meeting in print form, on CD-ROM, and on 3.5" floppy diskettes in both PDF and MS Word formats. Be sure to indicate your format preference on the Registration and Ticket Purchase Form. The materials from selected Committee Programs will be compiled and made available following the meeting. Both the Meeting Materials and Selected Committee Handouts print publications are available by subscription and for purchase

separately. For more information, look for the Meeting Materials order form in the next *Newsletter*.

Through a partnership with LEXIS-NEXIS®, the Section of Taxation is pleased to present ***Comm-Online***—a searchable database of Section Program and Committee Meeting Materials on the Section's website www.abanet.org/tax/.

AUDIO **TAPES**

Audiocassette tapes of committee programs and the Section programs will be available for purchase on-site as well as following the meeting. Produced by *Teach'em,* each program typically consists of two cassettes and costs only $20. To order, contact *Teach'em* at teach'em@bonus-books.com (800-225-3775).

COMPANION ACTIVITIES

Companion Activity tickets may be ordered by using the Registration and Ticket Order Form found in this *Newsletter*. Tickets are sold on a first-come, first-served basis.

FRIDAY, MAY 11

8:30A.M. – 9:15A.M. COMPANIONS' BREAKFAST

This complimentary breakfast will be held at the Grand Hyatt.

9:30A.M. – 2:00P.M. TOUR OF HILLWOOD ESTATE AND LUNCHEON

A tour of Hillwood Estate and special luncheon at Lavandou restaurant has been arranged for the companions. Hillwood, Marjorie Merriwether Post's elaborate twenty-five acre estate and gardens, has been closed for a number of years and has undergone a multi-million dollar renovation. It contains one of the most significant collections of Russian decorative arts outside the Russian Federation, as well as eighteenth century French furniture, tapestries and objects d'art. An expert on the collection will guide the tour.

Highlights of the magnificent grounds include the following: a Japanese garden complete with a foot bridge and a stream; a French garden paved with stone and a tiny canal; a pet cemetery guarded by stone poodles, a Russian "dacha" or cottage, a lodge housing a beautiful display of Mrs. Post's vast collection of American Indian artifacts; the C. W. Post Wing, filled with turn of the century American art and furniture; and a beautiful rose garden. Due to the popularity of this site, the tour size is currently limited to 34 people.

The companions' luncheon will be hosted at Lavandou, a homey, country French restaurant featuring classic regional fare. Located in the Cleveland Park neighborhood, it is one of Washington's most popular dining spots.

PROGRAM **THEME**

Whether you want an overview, refresher, or more advanced learning in a specific practice area, there's something for you at the 2001 May Meeting! Well over 60 committee meetings and programs scheduled over two full days will focus on the "Changing Business Environment" theme of the meeting.

The Changing Business Environment—Its Effect on the Legal Structure of Businesses and the Legal Relationship with Workers

Through most of the 20th century, the typical business organization in the United States and in many other countries was the corporation with wholly-owned subsidiaries. The need for flexibility in the new business environment has resulted in a choice of entities, which may look like a corporation, but which are taxed as a partnership, e.g., LLCs, LLPs, joint ventures, etc. In some cases a new or separate entity is not even established, but rather contracts, operating agreements and tracking stocks are used. For non-U.S. businesses the choices are even more creative. The most effective organization may be one that is characterized differently by various legal jurisdictions.

In addition, the typical employer-employee relationship has been restructured. For a number of years the issue of employee vs. independent contractor has been the focus of IRS audits. Outsourcing, which once was thought of as a cost reduction measure, has turned out to be a double-edged sword. Are workers employees or independent contractors? Who is the employer? Which entity should or can provide qualified retirement benefits and other employee benefits? What are the implications for taxation of compensation and benefits? How are deductions allocated where workers provide services to more than one entity?

PROGRAM HIGHLIGHTS

For the complete 2001 May Meeting Program Schedule, including dates and times, visit the Tax Section website after March 1, 2001, at www.abanet.org/tax/meetings/may01/.

A number of Section programs already are in the works, with more being planned, including:

- U.S. Activities of Foreigners and Tax Treaties – "Doing Business in Latin America"
- Capital Recovery and Leasing – "Useful Lives Out of Synch with Tax Depreciation Recovery Periods"
- Civil and Criminal Tax Penalties and Employment Taxes – "Criminal Prosecution of Employers Who Go To Excess Treating Workers As Independent Contractors"
- Committee Sponsor to be determined—"Wealth Transfer."

In addition, the Alternative Tax Systems Committee is organizing a blue-ribbon panel of experts to discuss the growing pressures that they believe will lead to the introduction

of a consumption-based tax in the United States. The growth in electronic commerce, U.S. multinationals' exposure to European VAT taxes, and the European Union's opposition to the income-tax based FSC regime and its successor are just some of the areas where pressure is growing on the traditional U.S. income tax system.

Entitled "**Globalization and the Growing Pressure for Fundamental Tax Reform**," the panel will discuss these and other factors that they believe will inevitably lead to fundamental tax reform. Prof. Murray Weidenbaum of Washington University, St. Louis, will provide the economic perspective. Prof. Weidenbaum was Chairman of the Council of Economic Advisers under President Reagan, and Assistant Treasury Secretary for Economic Policy under President Nixon, as well as the economic advisor on a number of consumption tax proposals. Ernest Christian, head of the Center for Strategic Tax Reform, in Washington, DC, and Deputy Assistant Treasury Secretary for Tax Policy under President Ford, will provide the policy perspective. Finally, the Committee is very hopeful that the Hon. Bill Archer, former Chairman of the Ways and Means Committee will provide a special legislative perspective. Mr. Archer has long argued for a radical change in the U.S. tax system, and for replacing the income tax with some form of consumption tax. All three panelists will offer their highly informed perspectives including the prospects for action during the Bush Administration.

AFFILIATED MAY MEETING PROGRAMS

WORKSHOP ON LOW INCOME TAXPAYER CLINICS, MAY 9-10

The Third Annual American University / ABA Section of Taxation Workshop on Low Income Taxpayer Clinics will be offered this year in conjunction with the May Meeting of the Section of Taxation, on Wednesday and Thursday, May 9-10, 2001, at the Marriott Metro Center in Washington, DC (just two blocks from the Grand Hyatt - HQ of the May Meeting).

As in prior years, the Workshop will present panels on low income and clinic issues by an experienced group of tax professionals, including tax clinicians from around the country and IRS representatives charged with administering the LITC Grant program. Panelists specifically will address the IRS grant making process, including changes in the timetable for grant applications and award decisions, recordkeeping and reporting responsibilities, and other issues. Panelists will also discuss important substantives and procedural developments in the low income area, the increasingly important role of the National Taxpayer Advocate's office, potential legislation affecting low income taxpayers, and the lobbying side of low income taxpayer representation (including its limitations for section 501(c)(3) organizations).

A new feature of this year's Workshop, because of the growing number of legal services organizations entering the field of low income taxpayer representation, will be breakout sessions addressing the separate needs of academic and nonprofit clinics.

Participants who attend the Workshop will receive a discount on the registration fee for the Tax Section May Meeting. For more information, please check the ABA website www.abanet.org/tax/, or call the Section office at 202/662-8670.

ANNUAL INTERNATIONAL TAX SEMINAR, MAY 9-10

The International Bar Association (IBA) Committee N —Taxes and the ABA Section of Taxation will present the second annual IBA International Tax Seminar in conjunction with the ABA Tax Section's May Meeting. Entitled "International Tax Developments: Cost Sharing and Joint Development Agreements; Cross Border Equity Compensation Arrangements; and Taxation of Outbound Transfers of Assets to CFCs and CFPs, and Related Information Reporting and Compliance Issues," this seminar will be held on Wednesday and Thursday, May 9-10, 2001 at the Grand Hyatt Washington, the headquarters of the 2001 May Meeting.

The program is designed in four half-day sessions, which will cover the hottest international tax issues arising in several countries around the world, allowing for in-depth analysis of issues in each country represented. It will address issues for a wide range of practitioners, professionals, and in-house international tax personnel and will provide both a survey of the basics for those with little experience and a deeper discussion of important developments for those with more expertise.

For more information, please contact:

Conference Department
International Bar Association
Tel: +44 0 20 7629 1206
Fax: +44 0 20 7409 0456
Email: confs@int-bar.org
Website: www.ibanet.org

2001 MAY MEETING HOTEL RESERVATION FORM

Please compete the form based on your hotel preference and return to each accordingly.

RETURN BY FRIDAY, APRIL 6

We urge you to make your reservations early; the hotels frequently sell out prior to the deadline.

Group: ABA Section of Taxation
Group Dates: 5/8/01 - 5/13/01

Name ______________________________

Co-Affiliation ______________________________

Address ______________________________

City ______________________________

State ______________ Zip ______________

Phone ______________________________

Fax ______________________________

Room Requests

__ Non-Smoking Room __ Confirmation Requested via Fax
__ Handicapped Accessible Room

Arrival Date__________ Departure Date __________

Arrival Time _____ a.m. _____ p.m.

Payment Information

❑ VISA ❑ MasterCard ❑ American Express

Card No______________________________

Exp. Date ______________________________

Signature______________________________

Check enclosed $ ______________________________

Grand Hyatt Washington — SECTION HEADQUARTERS

1000 H Street, NW
Washington, DC 20001-4310
Tel: 202/582-1234
Fax: 202/628-1641

	Convention Rates	Business Plan*	RC**
Single Occupancy	$199	$219	$234
Double Occupancy	$229	$249	$264

The Grand Hyatt Washington regrets that it cannot hold your reservation after 4:00 p.m. on the day of arrival without guaranteeing the reservation with a credit card or check made payable to "The Grand Hyatt." Check-in time is after 3:00 p.m. Check-out time is 12:00 noon. Late departures will be charged full nights's rate plus taxes. Cancellations or modifications of reservations must be made at least 24-hours prior to arrival to avoid forfeiture of deposit. Please provide credit card information or indicate paying by check or money order.

___ King Bed ___ 2 Double Beds

One bedroom suites available upon request. **We urge you to make reservations early; the hotel frequently sells out prior to deadline.**

*Business Plan Accommodations include separate floor, work station, coffee maker, in-room fax, continental breakfast and complimentary fitness center.

**Regency Club accommodations include complimentary continental breakfast, hors d'oeuvres, full time concierge and upgraded guest room services and amenities.

Marriott Metro Center

775 12th Street, NW
Washington, DC 20005
Tel: 800/228-9290
Fax: 202/824-6106

____ **Single/Double Occupancy** **$199**

___ King Bed or ___ 2 Double beds

Check-in time is 4:00 p.m. or earlier based on availability. Check-out time is 12:00 noon.

Make checks payable to "Marriott Metro Center."

Cancellations must be made by 6:00 p.m. on the day of arrival to avoid one night's room and tax charge. Your reservation cannot be held after 6:00 p.m. on the day of arrival without guaranteeing the reservations by check or credit card.

2001 MAY MEETING REGISTRATION AND TICKET PURCHASE FORM

Advance Registration Forms with full payment must be postmarked or faxed by April 13, 2001. There is a $50 fee for all cancellations. NO REFUNDS will be made for cancellations received after April 13, 2001. Only those registrants whose forms are postmarked by April 13, 2001 will be included on the Attendees' List. Tickets are sold on a first-come, first-served basis. Those with disabilities or special needs call 202/662-8670. TDD 202/662-1012. Confirmations will be sent. Send a self-addressed 9" x 12" envelope for information on Washington, DC.

INFORMATION

(Please type or print clearly.)

Attendee Name: ______________________
ABA ID No.: ______________________
St. Bar No: ______________________
Companion Name: ______________________
Firm or Agency: ______________________
Business Address: ______________________
____
City/State/Zip: ______________________
Daytime Telephone: ______________________
Fax: ______________________
E-mail: ______________________
Home Address: ______________________
City/State/Zip: ______________________

INFORMATION

If Postmarked or Faxed	by 4/13/01	after 4/13/01
Check one:		
Regular Member/Associate	__ $315	__ $365
Foreign Lawyer	__ $315	__ $365
Young Lawyer (admitted to the bar less than 3 years)	__ $210	__ $245
Full-Time Law Professor	__ $75	__ $85
Government Official	__ $75	__ $85
Non-Section Member*	__ $355	__ $415
Full-Time J.D./LL.M. candidate	__ waived	__ waived
First Time Tax Section Member	__ waived	__ waived

*ABA members registering will become Tax Section members for 2001.

Registrants will receive one version of the meeting materials.

Check one.

_ Traditional book version only:	*included in registration fee*
_ On Diskette only (Windows version).	*included in registration fee*
_ On CD-ROM only (Windows version).	*included in registration fee*
_ Traditional book version with CD-ROM:	additional $60 Charge
_ Traditional book version with diskettes:	additional $50 Charge

Unable to Attend the Meeting?

Mail the following materials after the Meeting:

___ Meeting Materials on Diskette	$50.00
___ Meeting Materials CD-ROM	$60.00
___ Meeting Materials traditional book version	$65.00
___ Selected Committee Handouts	$75.00
Shipping/Handling	$ 5.95
TOTAL	______

RETURN TO:

Meeting Registrar
ABA Section of Taxation
740 15th Street, NW, 10th Floor
Washington, DC 20005-1022
Or Fax to (202) 662-8682

For Tax Section Use Only
Check # ______________
Amount Rec'd $__________
Initials ______________

TICKETED FUNCTIONS

FRIDAY, MAY 11

COMMITTEE BREAKFASTS

No.	Function	Ticket
1	Breakfast with Charles O. Rossotti, Commissioner, IRS **Important : Please indicate attendance**	___ at No Charge =$0.00
2	Exempt Organizations Subcommittees on Health Care, State and Local Taxes, and Tax Exempt Financing	___ at $30 each =$_____
3	Exempt Organizations Subcommittees on Private Foundations, International Philanthropy, and Unrelated Business Income	___ at $30 each =$_____
4	Exempt Organizations Subcommittees on Religious Organizations	___ at $30 each =$_____
5	Exempt Organizations Subcommittees on Political and Lobbying Organizations	___ at $30 each =$_____

TOUR/ACTIVITY

No.	Function	Ticket
6	Hillwood Estate	___ at $85 each =$_____

COMMITTEE LUNCHEONS

No.	Function	Ticket
7	Administrative Practice and Court Procedure	___ at $45 each =$_____
8	Agriculture	___ at $45 each =$_____
9	Banking and Savings Institutions, Financial Transactions, Regulated Investment Companies	___ at $45 each =$_____
10	Civil and Criminal Tax Penalties	___ at $45 each =$_____
11	Corporate and Affiliated & Related Corporations Tax Transactions	___ at $45 each =$_____
12	Estate and Gift Taxes and Fiduciary Income Tax	___ at $45 each =$_____
13	Exempt Organizations	___ at $45 each =$_____
14	Foreign Activities of U.S. Taxpayers, U.S. Activities of Foreigners and Tax Treaties, Foreign Lawyers Forum, Transfer Pricing	___ at $45 each =$_____
15	Individual Income Tax, Partnerships and Real Estate	___ at $45 each =$_____
16	S Corporations	___ at $45 each =$_____
17	State and Local Taxes	___ at $45 each =$_____

SECTION RECEPTION

No.	Function	Ticket
18	Section Reception	___ at $65 each =$_____

SATURDAY, MAY 12

COMMITTEE BREAKFASTS

No.	Function	Ticket
19	Individual Income Tax, Partnerships, and Real Estate	___ at $30 each =$_____
20	State and Local Taxes	___ at $30 each =$_____

SECTION LUNCHEON

No.	Function	Ticket
21	Section Luncheon	___ at $35 each =$_____

COMMITTEE RECEPTION

No.	Function	Ticket
22	Employee Benefits	___ at $60 each =$_____

TOTALS

Registration Fee	$ ___________
Additional CD ROM/Diskette	$ ___________
Ticket Total	$ ___________
TOTAL PAYMENT	

PAYMENT INFORMATION

$ ___________

Make checks payable to ABA SECTION OF TAXATION or fill in the credit card information below. MUST PRINT CLEARLY.

Check One: __ Master Card __ VISA __ AmEx

CARD NO: ________________________________ EXP. DATE: ________

SIGNATURE: ____

A NEW RESOURCE FOR NAVIGATING IRS WATERS

by Jerome Borison, Denver, CO

The creation of the Tax Section's new book, "Effectively Representing Your Client Before the 'New' IRS," dates back to an August 1, 1994, meeting, called by Phillip Mann and John (Jack) Nolan, both of Miller and Chevalier. The meeting was convened to explore what the ABA Section of Taxation could do to promote taxpayer compliance as a follow up to its earlier success with respect to its "Nonfiler Initiative." Many low income taxpayer advocates and interested Tax Section members attended the meeting. I attended the meeting as chair of the Section's Low Income Taxpayers Committee.

The attendees were particularly intrigued by the concept of low income taxpayer clinics and how the Section could promote them. Several models were viewed as viable, among them being clinics established by local tax bar associations or independent nonprofit organizations, staffed by volunteer tax professionals. Participants felt there were many tax attorneys who would like to do pro bono work but who did not have a tax vehicle for doing so.

The participants identified a barrier that had to be overcome before tax attorneys would sign up for this kind of volunteering—many tax attorneys, such as estate or corporate planners, have little or no experience representing clients before the IRS and even less experience representing low income taxpayers. The proposed solution involved creating a short manual of common scenarios to which the volunteer attorney could turn for assistance on how to proceed. The Low Income Taxpayer Committee submitted this proposal to the Tax Section. At its May, 1996, meeting, the Section's Council approved the manual's publication and provided grant funds to cover certain administrative and production costs.

With the ABA Tax Section's imprimatur on the project, the Low Income Taxpayers Committee was able to recruit more than a dozen heavyweights in the tax controversy arena to write individual chapters. I agreed to edit the chapters. All of the authors signed on as volunteers with the understanding that "profits" would be used by the Tax Section to sponsor low income taxpayer initiatives.

The final product, delayed in part by the enactment of the 1998 Revenue Reconciliation Act, is significantly different from the short manual originally anticipated. We discovered early on that the procedural problems faced by low income people are the same as those experienced by more affluent taxpayers. Additionally, we realized that one cannot discuss many of the alternative solutions to tax controversies without having a more foundational and detailed discussion of tax procedure. As a result, the Low Income Taxpayers Committee decided to expand the scope of the book and write it in such a way that it would help any tax professional (attorney, accountant, or enrolled agent) navigate through the IRS seas and shoals.

The result of four years of intensive labor is a two-volume, 1,780-page book, complete with a CD-ROM of the entire text. The manual is unique in its practical, hands-on approach. It not only provides the reader with a discussion of the law but also suggests what questions to ask of your client, what evidence to obtain, with whom to work at the IRS, and how to reach a successful resolution of the controversy. It is replete with hundreds of very practical tips. It also has sample correspondence and forms to avoid the "reinventing the wheel" feeling we all experience now and again. It is the product of tax attorneys who are at the peak of their profession and who dedicated their time and energies to provide the means to representation for low income taxpayers. Through their unselfish efforts on behalf of the under-served, we now have a book that addresses the needs of all taxpayers and that all tax practitioners should have in their libraries.

**EFFECTIVELY REPRESENTING YOUR CLIENT BEFORE THE "NEW" IRS:
A PRACTICAL MANUAL FOR THE TAX PRACTITIONER
WITH SAMPLE CORRESPONDENCE AND FORMS**

8 1/2 X 11, Softcover, 1780 pages, includes CD-ROM
$240 Section Members, $290 Nonmembers, $145 Nonprofit/Academic/Govt
ABA Product Code 5470498

Call the ABA Service Center - 800/285-2221
www.abanet.org/tax/pubs

NEWS BRIEFS

STANDARDS OF TAX PRACTICE STATEMENT 2000-1

The Section of Taxation's Committee on Standards of Tax Practice has issued Standard 2000-1 for the guidance of tax practitioners. The standard addresses whether differences between the income tax return accuracy standards for taxpayers and the lawyers who advise them result in conflicts of interest between clients and their lawyers. Specifically, it explores whether the benefits of adequately disclosing return positions, which may affect taxpayers and advisers differently, generate conflicts of interest. The statement is available on the Committee's home page at www.abanet.org/tax/groups/stp/stmt00-1.html.

FOUNDATION TO SPONSOR STUDENT WRITING COMPETITION

The Theodore Tannenwald, Jr. Foundation for Excellence in Tax Scholarship was recently formed as a public charity to sponsor, in conjunction with the American College of Tax Counsel, an annual law student writing competition in the field of taxation. The Foundation is named for the late Tax Court Judge Ted Tannenwald, who served on the Court for 35 years (including as Chief Judge from 1981-83) and authored more than 1,000 opinions. He was widely acclaimed as a superb jurist, and was a revered mentor and friend to generations of young tax lawyers and his colleagues on the bench. Long active in the Tax Section, he was a member of Council and the recipient of the 1998 Distinguished Service Award.

The writing competition is open to both J.D. and LL.M. students, with all papers to be submitted under the sponsorship of a tax professor. Entries for the first competition are due by June 30, 2001. Cash prizes will be awarded, and one of the winning papers will be published in the *Tax Lawyer*. The Foundation has thus far received several significant leadership gifts and is presently in the midst of a general contribution campaign. Contributions of any amount would be greatly appreciated and should be sent to The Tannenwald Foundation, Suite 200, 1275 Pennsylvania Ave., N.W., Washington, D.C. 20004. Inquiries regarding the Foundation may be directed to Herb Beller (202/383-0120), Mark Silverman (202/429-6450) or McGee Grigsby (202/637-2200).

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INTERNATIONAL TAX CONFERENCE IN AMSTERDAM APRIL 4, 2001

The International Bar Association (IBA) Committee N - Taxes and the ABA Section of Taxation will cosponsor a cutting-edge, CLE program in Amsterdam on April 4, 2001. This conference is a one-day review of the hottest international tax issues. It is designed to address issues relevant to a wide range of practitioners, professionals and in-house international tax personnel.

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10TH ANNUAL ABA/IPT EVENT—MARCH 20-23, 2001

The ABA Section of Taxation and the Institute for Professionals in Taxation (IPT) have joined forces to present the 10th Annual Advanced Sales/Use Tax and Advanced Property Tax Seminars. The seminars will take place on March 20-23, 2001, at the Hotel le Meridien in New Orleans. For the latest schedule and registration information, contact the ABA Section of Taxation at 202/662-8670.

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TO THE EDITOR

I welcome the publication of [“Installment Sales to Defective Grantor Trusts” by D. Silverman, Sec. Tax’n Newsl., Fall 2000 at 11], since it enables me to say in public what I have been saying in private for some time, without earning the opprobrium of those who are using this technique for blowing their cover.

Viewed from the perspective of someone who practiced in the 1970s and ‘80s, the notion that by making an installment sale to an intentionally defective grantor trust (a better term would be an intentionally grantor-taxed irrevocable trust) a taxpayer can transfer her estate to her beneficiaries while avoiding both income taxes on the sale and estate and gift taxes is simply laughable.[1]

The point of this letter is not to make the various technical arguments which can be made against the technique, which should be obvious to all competent tax practitioners, but to wonder that an attorney could fashion a spiel to convince his client, and worse, himself, that such a position might be sustainable upon examination by the Service or in Tax Court.

Return with us to the thrilling days of yesteryear, when the tax-shelter lawyer rides again! Selecting a line from the statute here, a private letter ruling there, and a revenue ruling over yonder, the Masked Man concocts an argument, prepares the documents, collects a fee, and “Heigh-ho, I’ve got the Silver, Away!”

Do we not remember the rule of 78’s depreciation, the advanced royalty payment, the investment tax credit strip, the “losses are ordinary, gains are capital” allocations, and all of the other techniques which, like the sale to the intentionally grantor-taxed irrevocable trust, were based upon inapplicable, out-of-context, or simply incorrect statements of law? Have the principles that in tax law, substance prevails over form, and that sham transactions are ignored, been overturned? Have we forgotten the hundreds of millions, perhaps billions, of dollars paid in taxes, interest, and penalties by participants in the tax shelters of the ‘90s and ‘80s? Or perhaps we hunger for those days again, when we could collect fees for putting clients into contrived tax schemes and more fees for getting them out?

I had thought that as tax lawyers, we had learned our lesson from the tax shelter debacle of the 1980s, but I see by the corporate tax shelter promotions that we have not. I had thought that those of us practicing in the estate planning area were above this sort of thing but I see from the “ghoul charitable lead trust[2]” and the sale to the intentionally grantor-taxed irrevocable trust that we are not.

Tax lawyers have a dual responsibility: to our client and to the tax system as a whole. It should not be necessary for any of us to learn this by means of the IRS imposing preparer, tax shelter promoter, and aiding and abetting penalties, but if it is, so be it.

Very truly yours,
Mitchell R. Miller
Beverly Hills, California

DAVID SILVERMAN RESPONDS

The general principles governing the tax consequences of asset sales to intentionally defective grantor trusts seem firmly grounded in the Code and the law, and their straightforward application appears to result in the tax conclusions which were outlined. Nevertheless, the IRS could challenge various parts of the transaction, which if successful, could negate some (or all) of the tax benefits sought. In particular, the IRS could attempt to assert that (i) the initial "sale" to the grantor trust is actually a taxable sale which results in immediate tax to the grantor under IRC section 1001; (ii) IRC section 2036

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1 In theory, the fair market value of the property at the time of transfer is included in the taxpayer’s estate by virtue of the installment obligation and its proceeds, but an important part of these schemes is the elimination of these assets from the taxpayer’s estate as well.

2 A charitable lead trust whose measuring life is that of a fatally—but not terminally—ill individual, usually not related to the donor of remainder beneficiaries of the trust, and frequently rounded up from a list of nursing home or AIDS patients.

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applies, with the result that the entire value of the trust is includible in the grantor's estate; (iii) that IRC section 2702 applies, the annuity is not qualified, and a taxable gift occurs at the outset; or (iv) the step transaction doctrine applies.

I disagree, however, with Mr. Miller's assertion that the tax treatment espoused is inherently sinister. Similar arguments made against minority discounts for LLCs have been rejected by the courts. According to the ABA Formal Opinion 85-352, "a lawyer who is asked to advise his client in the course of the preparation of the client's tax returns may freely urge the statement of positions most favorable to the client just as long as there is reasonable basis for this position." Failing a successful IRS challenge, the technique could substantially reduce estate taxes. Clients should be apprised of risks. However, we should not be so presumptuous as to assume that an informed client is incapable of making an intelligent choice when implementing an estate plan. Asset sales to defective grantor trusts deserve further consideration.

Very truly yours,
David L. Silverman
Great Neck, New York

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