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CONTENTS

FROM THE EDITOR 3
FROM THE CHAIR 3
FROM THE CHAIR-ELECT 5
SPECIAL REPORT 7
POINTS TO REMEMBER 10
POINT & COUNTERPOINT 14
INTERVIEW WITH GROVER G. NORQUIST 17
SPOTLIGHT ON COMMITTEES..20
PRO BONO AWARD RECIPIENT: PETER LOWY 21
JOINT FALL CLE MEETING..25
COUNCIL ACTIONS 27

FROM THE **EDITOR**

by Alice G. Abreu, Philadelphia, PA

This is the last issue in this volume of the *NewsQuarterly*. With it we mark the end of one Chair's term and the start of another's, so we open with columns from both. Outgoing Chair Herb Beller reviews recent Section activities, extends some much deserved thank-yous, and urges that we deepen our commitment to attracting younger members to the Section. Incoming Chair Dick Shaw sets out his agenda for the forthcoming year and explains the challenges the Section is now facing.

We are proud to feature a Special Report on benefits shelters ably and amusingly written by long-time Section member Alvin Lurie, as well as Points to Remember from Doug Davenport and Kelsey Lemaster on the deductibility of software costs associated with enterprise resource planning and from Shannon Nash on what every lawyer who sits on the board of an exempt organization ought to know about intermediate sanctions.

Jack Cummings and Alan Swirski have outdone themselves by interviewing Grover Norquist, President of Americans for Tax Reform, who has been called the most influential man in Washington and whose views are shaping tax legislation as I write. Learning about him and his organization is vital for anyone interested in the structure of the tax system and the content of future tax legislation. I promise a riveting read.

As usual, Chris Rizek has produced a lively and important Point/Counterpoint debate which takes up an issue raised by Herb Beller in his Chair's column in the Spring issue of the *NewsQuarterly*: whether previous tax experience should be required of Tax Court nominees. Michael Mulroney persuasively says no while Brian Camp offers an emphatic yes. Both are convincing and their pieces demonstrate why this is such a difficult question.

Finally, this issue honors Peter Lowy, this year's recipient of the Section's Pro Bono Award, and spotlights the activities of the Real Estate Committee. Both are inspiring. ■

FROM THE **CHAIR**

by Herbert N. Beller, Washington, DC

HERBERT N. BELLER

I'd like to use this, my last column as Chair, to bring you up to date on some recent Section activities, and to recognize some of our colleagues who have played especially significant roles in making this another great year for the Section.

MAY MEETING

Our May meeting in Washington was a huge success, with record attendance (over 2,000) and, as usual, strong participation by our government friends. The then pending tax legislation added an important dimension to the meetings. Many of our government guests were directly involved in the legislative action, yet still found time to be with us and to provide first-hand information on the rapidly evolving developments.

We also were fortunate to have IRS Deputy Commissioner Bob Wenzel as our Saturday luncheon speaker. Bob filled us in on some important operational programs and initiatives now in progress at the Service. He also shared some valuable insights as to challenges that lie ahead, based on his over 40 years experience at IRS (including a recent and very productive stint as Acting Commissioner). We congratulate Bob on his outstanding public service achievements and wish him well in his upcoming retirement.

Also at the May luncheon, we presented the Section's Distinguished Service Award to M. Bernard Aidinoff and our Pro Bono Award to Peter Lowy. Among numerous other outside professional, charitable and community activities, Bernie chaired the Section in 1982-83, held several other Section leadership positions and served for six years in the ABA House of Delegates. Peter was honored for his extensive volunteer efforts in the Houston area on behalf of low-income taxpayers.

RECENT GOVERNMENT SUBMISSIONS

Since May we have submitted Council-approved comments concerning a number of important tax legislative subjects. Our submission on the proposed codification of the "econom-

ic substance" doctrine expressed serious reservations about the administrability of that proposal and its potential impact upon numerous legitimate tax planning strategies. (David Garlock, Greg May and Bill Paul carried the main oar on this excellent piece of work.) We also commented on the dividend exclusion provisions contained in the Administration's Budget Proposals and the Senate version of the Jobs and Growth Tax Act of 2003. (A special working group headed by Jack Cummings developed this very comprehensive and incisive work product in an amazingly short period of time.)

Other recent submissions addressed tax simplification aspects of the Budget Proposals (jointly with AICPA and TEI); the proposed repeal of the section 911 foreign earned income exclusion; proposed amendments to the Code provisions governing S corporations; the earned income tax credit pilot "pre-certification" program; proposed revisions to the partnership K-1 form; international activities of section 501(c)(3) organizations; a Treasury proposal with respect to defined benefit plans; legislative proposals to broaden the reach of section 269 and tighten the section 362 basis rules; and frivolous requests for collection due process hearings. In addition, based on input received from several committees, we recently provided to Treasury and IRS numerous recommendations for items to be included in the 2003-04 Guidance Priority List. Special thanks to Armando Gomez, incoming Chair of our Government Relations Committee, for coordinating this project.

All of these submissions can be viewed on the Section website at www.abanet.org/tax/.

SOME THANK-YOUS

Serving as Chair of the Section has been a great privilege, as well as an enervating and enjoyable experience. My main goal was to make sure that the Section continued *to make a difference for our members and for the tax system*. Through the many activities and programs described in my prior columns, I hope you'll agree that we have indeed done that in a number of concrete ways.

The enormous amount of hard work that's done at the committee level is of course the cornerstone of our continuing success. Much thanks is due to VCCO Mike Hirschfeld and the committee chairs and vice-chairs for their invaluable efforts in keeping this huge engine humming—and a special thank you to Diane Jones, who is retiring after 16 years of outstanding service as the Section's Committee Coordinator.

Credit also is due to our outstanding group of Section Officers and Council members. Chair-Elect Dick Shaw provided substantial support and the benefit of his good judgment throughout the year. I'm confident that the Section will continue to thrive under his leadership. I also want to express appreciation for the distinguished service of outgoing Vice-Chairs Karen Hawkins (Professional Services), George Howell (Communications) and Bill Wilkins (Government Relations); outgoing Secretary, Susan Stone; and outgoing Council members Stevie Conlon, Stuart Lewis and Janet Spragens. I consider myself very fortunate that these dedicated and talented individuals were on the Section leadership team during my term.

As we all know, the work of the Section would surely grind to a halt without the terrific help of our Executive Director, Christine Brunswick, and her very able Washington staff. A tremendous amount of behind-the-scenes work goes into planning our meetings and overseeing the nitty-gritty of our between-meetings activities. But somehow Momma Chris and her posse always manage to get the job done well and on time. Thanks to all of you!

A WORD ABOUT THE FUTURE

As the nation's largest organization of tax lawyers, the Section provides unparalleled continuing legal education and networking opportunities, sponsors important tax-oriented *pro bono* and public service activities, and works closely with our government counterparts towards improving the content, administration and enforcement of the tax laws. In order to perpetuate our national stature and the significant impact that we have upon the tax system, it is critical that we continue to attract younger members and involve them in the work of the Section. We are making good progress at this, but need to do better. Through the Nolan Fellows program, we have identified a number of younger tax lawyers who already are making substantial contributions at the committee level or in other ways. Our Young Lawyers Forum is a vibrant and steadily growing group, whose members are eager to find a home and actively participate in substantive Section committees. Let's do everything we can to give them that opportunity. The Section's future depends on it! ■

WWW.ABANET.ORG/TAX/

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• *Comm-Online* (online, searchable database of committee program materials)
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QUESTIONS? **Contact the Section's Technology Specialist at taxweb@staff.abanet.org.**

FROM THE CHAIR-ELECT

by Richard A. Shaw, San Diego, California

RICHARD A. SHAW

The Tax Section has completed another challenging and successful year under the strong leadership of Herb Beller, the officers, Council directors, and many committee chairs and vice-chairs. Particular credit goes to the professional manner in which the Section provided national leadership in dealing with hot tax issues, such as the tax shelter disclosure regulations, Sarbanes-Oxley, dividend exclusions, and the definition of "economic substance." During the past year, the Section has demonstrated that its voice needs to be heard in the formulation of new tax legislation and administrative policy.

I am honored to have the opportunity to chair this special organization for the next year. Yes, I will admit that I joined the Tax Section in the early 60s. I participated in those day-long plenary sessions when committee chairs sat in the front row (with signs) and explained proposed legislative changes and revenue rulings to the full august body. We listened to our distinguished elders argue the merits and demerits of each on the floor. I remember that sages such as John Pennell, Lippy Redman, Jack Nolan and others (frequently Ed Benjamin) had much to offer and through those efforts, we strengthened the federal tax system. I also suffered through the cigars of Bernie Aidinoff and Irwin Treiger on the Council at a later time. In those earlier years, the Section was much smaller and member involvement with the government was only occasional, and for the average member, essentially nonexistent.

Now 20,000 members strong, we have a significant direct working relationship with the Service, Treasury, Justice Department, and The Hill. They seek and respect our objective input on legislation and administrative guidance. We have protected and nurtured this image to assure that Section comments are properly perceived as targeted toward an improved, simple, fair and just tax system, not an effort for private advantage. It is important that we recognize this heritage and strive to maintain the high integrity and ethical standards that are the image of this Section.

ETHICS AND STANDARDS OF PRACTICE

As we look forward to the coming year, one of my goals is to emphasize the responsibility of the Section and our members to promote a high standard of professional ethics and standards of practice. To that end, Karen Hawkins has been appointed to the new position of Tax Section Liaison with the Service's Office of Professional Responsibility. Gersham Goldstein has been asked to serve in a similar capacity with the Section Officer's Conference of the ABA. Our Standards of Tax Practice Committee under Chair, Michael Lang, will maintain an active role in this endeavor. We want to plan a major program on ethical-do's and don'ts, during my term.

On July 26, 2002, the Service released significant amendments to Circular 230, but deferred action on revised guidance for tax shelter opinions. Our Section earlier participated in modernizing those provisions and should actively promote efforts to update standards to assure that tax lawyers understand and apply high professional standards in giving tax shelter advice, conducting appropriate due diligence, and rendering tax opinions on behalf of clients.

Congress and the administration continue to demonstrate concern with the proliferation of abusive tax shelters in recent years. The Service will continue to make tax shelters a prominent enforcement issue. The Section supports efforts to force tax shelters into the sunshine and the imposition of penalties for failure to adequately disclose abusive transactions. While the Section supports and encourages disclosure, it is important that such disclosure be structured with clear guidelines that will not impinge unfairly on bona fide business transactions.

With that in mind, I have asked outgoing Chair, Herb Beller, to continue to serve as a Council Director on the Tax Shelter Task Force. Dealing with the tax shelter disclosure problem has been a major cornerstone of his administration. The Tax Shelter Task Force, under its able chair, Bill Paul, will have much to do this year. The Task Force is presently examining the proper scope of "confidentiality" under the tax shelter disclosure regulations.

MEMBER VALUE

I have always believed that there is value to membership in an organization, only if there is enough personal benefit and return on investment of time and money to justify belonging.

Over the last two years, I have been charged with examining the values and benefits that attorneys obtain from our Section. That effort culminated in the completion this May of a survey of Section members. The resulting report provides significant data about who our members are and what they want. We will want to share much of this data and the conclusions obtained with our members. Section officers, Council directors

and committee officers want to actively participate in our efforts to assure that every member has the opportunity to obtain material value for belonging to the Section. We will explore how to improve these opportunities and benefits during the year. I have asked Past Vice Chair, Susan Serota, to continue her membership and marketing leadership for this task. She and I are now working to get greater involvement of tax attorneys in the Chicago area in attendance at our Fall Meeting. If you have not been coming to our meetings, please come in out of the cold. We will have a great time in Chicago.

It is important that our new mentoring program get off to a good start under the guidance of Jerry August and Wayne Hamilton. The Diversity Committee and Young Lawyers Forum are providing the impetus for success.

JOINT FALL CLE MEETING WITH RPPT

It is not too late to plan to attend our Fall Joint CLE Meeting with the Real Property Probate and Trust Section on September 11-13, 2003. A great deal of special attention has gone into planning special technical joint programs for both Sections. At the luncheon on Saturday, we will have a special and very entertaining program by Paul Bergman, the author of "Reel Justice." He will present film clips and commentary on lawyers' ethics and advocacy in the movies. You will not want to miss this program.

BUDGETARY CONCERNS

Even in the bright sunshine of day, we are discovering there are shadows that bear hidden problems. As I focused on this year and sought to reduce the cost of membership and expend more resources to increase benefits for members, we discovered that the Tax Section has been seriously and adversely impacted by the disastrous stock market. In past years, we have set larger budgets, relying upon substantial returns from the stock market. Now, we are finding that budgets at that level are significantly eating into our reserves. This means that we will need to curtail some of the things we do and will need to exercise initiative in finding new ways to give members benefits they want.

As I write this piece, the Council is carefully reviewing our budget for next year. I hope that you will each be patient as we work to maintain fiscal responsibility in our budget for the year. There will have to be some adjustments. For example, we will still have coffee and pastries at Section meetings. However, they may not be available all day long.

We will rely much more on the Tax Section home page (www.abanet.org/tax) and the committee websites to make information and articles available. The committee websites will be a primary source for obtaining committee information. The Section will use the Internet more to communicate with members. We now have email addresses for only 60% of our members. Please make sure that the Tax Section Office has your email address now.

A POTPOURRI

As I undertake my responsibilities as Chair, it is evident that there are many other ongoing matters that are of importance to the Section.

Simplification. We must continue to promote simplification through joint efforts with the American Institute of Certified Public Accountants and the Tax Executives Institute to enhance public focus and remind Congress continually of the need to simplify the tax laws.

Pro Bono Support. Peter Lowy was this year's recipient of our Public Service Award. I have asked Dick Lipton and his Pro Bono Committee to prepare a formal set of standards for use in recognizing pro bono tax service in the future. The Section will continue to promote taxpayer clinics and needs to be an active participant in helping to make the earned income tax credit work. This includes technical comments on the use of pre-certification for the EITC.

Dividends, International Taxation and Transfer Taxes. There is a need for administrative guidance and likely statutory tweaking arising from the dramatic change in dividend rates and the impact of short-term sunset clauses. The present Task Force on International Taxation under Chairs Steve Shay and Len Schneidman will present a report at the August Council meeting. We also look forward to a report from Lloyd Leva Plaine and Jerry August on the difficult issues faced with transfer tax reforms. We have much to do this year.

NEW LEADERSHIP

Your new leadership team is up and running. It is a pleasure to see new Chair-Elect Ken Gideon step forward so quickly. We have already benefited greatly from his input.

Our new Vice-Chair Government Relations, Stu Lewis, has already gotten both feet wet, as have Celia Roady (Communications), Bob McKenzie (Professional Services), and our continuing Vice-Chairs, David Raish (Publications), Stanley Blend (Administration), and Michael Hirschfeld (Committee Operations) have theirs soaked.

New appointments for liaisons with the Internal Revenue Service include Don Korb (LMSB), Janet Spragens (W&I), Susan Serota (TEGE), and Karen Hawkins (OPR). Each assures that we have an open line of communication with the Service's Divisions.

ABRA AND LEXIS-NEXIS

I also want to take a minute to thank the American Bar Retirement Association (ABRA) for hosting the May Tax Section Luncheon. This ABA organization sponsors some 5,000 law firms and approximately 60,000 lawyers qualified retirement plans with $4 billion in invested assets through its Trustee, State Street Bank and Trust Company. We appreciate this support and the long-term support of our general Primary Legal Publishing Sponsor, Lexis-Nexis. ■

SPECIAL REPORT:

BENEFITS TAX SHELTERS: IN EYE OF THE BEHOLDER OR EYE OF THE STORM?

by Alvin D. Lurie, New Rochelle, NY

Do you remember when pension practitioners proudly bore their identification as architects of the "quintessential tax shelter"? Not any more. Their reply today is more likely to be, "Who, me?" Association with a tax shelter—*any tax shelter*—is to be avoided like spam. This is quite new in the benefits community, whose practitioners mostly believed themselves to be, shall I say, sheltered from the growing concerns that have bedeviled tax lawyers generally, as if they existed in a closed universe bounded only by the borders of ERISA. Dividend and lease stripping, basis shifting, special income allocations to tax-indifferent partners, off-shore trusts and other such tax-depressing tactics that have attracted the fire of the abusive-tax-shelter fighters in the Service and Justice were not part of the benefit planner's tool kit.

In fact, when I first set out to write, in various venues, about the potential vulnerability of benefits practitioners to the dragnet that was entrapping providers of abusive tax schemes, I was concerned that my pieces would be received with a big yawn if anyone even troubled to read them. But then the fireworks began. It was as if I had gotten the Big Guy up there concerned lest my perception of the level of disinterest my fellow practitioners were likely to show in my "ethics" pieces might be accurate, and he determined to unleash a series of thunderbolts to get their attention. No sooner did I get into print (or, sometimes, into bits and bytes) than the benefits landscape took a series of hits (read judicial decisions, "listed transactions", IRS news releases and announcements, regulations, congressional reports, newspaper and periodical articles, and speeches by high government officials), all portending that benefits practitioners better be prepared to meet the enemy because it was they.

YOU CAN'T STOP THE PRESSES

In one sense, I was vindicated in my choice of topic. But how does one ever complete an article without flinching at the prospect of a post-press-time news release likely to be issued, dating—if not obsoleting—the writer's words even before their publication? The only answer is you write another one; and that's exactly where I found myself on May 26th last when I caught up with the report entitled "TE/GE Abusive Tax Shelters Involving Tax-Exempt and Government Entities Project Group" (Jonathan B. Forman, project leader), issued May 20th and submitted to the Advisory Committee on Tax Exempt and Government Entities for transmittal to the Service's TE/GE Division (herein called the "TE/GE Report"). Hence, this piece.

If you think abusive tax shelters are on the back burner of the TE/GE Employee Plans and Exempt Organizations divisions, you will be quickly disabused upon reading the TE/GE Report—authored, please note, not by the government but by a distinguished private-sector advisory body appointed by the Service's TE/GE organization. That report is must-reading for all benefits lawyers (to say nothing of tax practitioners generally). If you need further convincing of the efforts the Service is devoting to its campaign against abusive shelters, go no farther than the Spring 2003 issue of this *NewsQuarterly*, where B. John Williams, Chief Counsel of the Service, in an interview, displays unconcealed delight with the success of three settlement initiatives in which he was most personally involved: the COLI settlements, the 302/318 initiatives, and the creative and flexible two-step program devised for addressing the so-called contingent liability shelters involving section 351 transactions. Also, in that same issue of the *NewsQuarterly* is a discussion of the knockout blow delivered by the Office of the Chief Counsel to a particular leveraged partnership transaction, by way of a Chief Counsel Advice, where the Service invoked an array of its weapons, including the partnership anti-abuse regulations, the disguised sale rules, the form-over-substance doctrine, and even complete nonrecognition of the very partnership structure itself.

As indicated, what prompts this piece is the TE/GE Report and its focus on the means to combat abusive shelters in the employee benefits universe. Of most interest (even to me, who was once inside the loop), the report provides a rare glimpse into how the Service gets wind of, then identifies, and, drawing together its forces, cracks down on an abusive shelter. The report also provides an excellent compendium of the full panoply of statutory, judicial and regulatory rules, compliance and enforcement mechanisms, and penalties available to the Service. The stated purpose of the establishment of the project group that produced the report was to study how the TE/GE Division could better respond to abusive tax shelters and other abusive schemes, with the goal of identifying and recommending additional strategies that can be used by TE/GE. The report even exhorts "legitimate practitioners who care about good tax policy" to

help the Service learn about potentially abusive schemes.

A NOT-SO-LITTLE LIST

One of the most creative weapons in the Service's arsenal is the "listed transaction" tactic. "Listed transactions," as readers of the *NewsQuarterly* well know, are tax-planning schemes that the Service has described as having a tax avoidance purpose and whose tax benefits are subject to attack under existing law. The listed transaction is one of several categories of so-called "reportable" transactions (including, inter alia, "confidential" transactions, programs with "contractual protection" of tax efficacy by the promoter by way of refund of fees paid to the promoter, and items with significant book-tax differences) that bear badges of potential tax avoidance requiring taxpayers participating in such a reportable activity to disclose the same on their tax returns. The TE/GE Report observes perceptively that listing a potentially abusive transaction "takes it out of the audit lottery" by giving the Service enough to decide if the transaction merits further investigation. If the audit lottery generally gives a taxpayer, operating under the present roughly 1% audit rate, 99-to-1 odds against detection, then a 100 percent audit rate would increase the chances of detection 10,000 % (if I did the math correctly)! I don't like the taxpayers' odds.

Listed transactions run the gamut of taxable transactions, principally those implicating the income tax; but starting this year the regulations also authorize disclosure of listed transactions involving federal estate, gift, employment, pension and exempt organization issues. Of course, pension issues implicate the income tax; and it will come as a surprise to even some experienced pension practitioners that the first two of the listed transactions identified in the Service's initial compendium of such transactions (Notice 2001-51) involved benefits plans, 401(k)s and ESOPs. Since then the Service has added 10-or-more plans under section 419A(f)(6) and collectively bargained welfare plans under 419A(f)(5). The next likely benefit plan added to the list will be section 412(i) retirement plans(expected imminently as this is written). The TE/GE Report confirms that "IRS is expected to issue formal guidance with respect to these abusive section 412(i) plans soon." (N.B.: the authors of that report have been talking directly to the Service personnel involved in this exercise.)

Of course, none of the plan types noted above are inherently abusive. Again quoting the report, "While there are many legitimate uses of section 412(i), the IRS has recently become aware of certain schemes that use section 412(i) as a vehicle of abuse." If you would know the depth of the Service's feelings about schemes that purport to fit within sections of the Code such as 419A(f)(5), but which "are, in fact, designed for no material purpose other than the improper exploitation of provisions that are appropriate only for legitimate collectively bargained plans", then you must certainly read Notice 2003-24 (4/11/03), which, taking its text from the just quoted passage of the applicable Ways & Means Committee report, paints an unmistakably sharp picture of the unforgiving posture of the Service regarding "certain arrangements purporting to qualify as collectively bargained welfare benefit funds." The notice "alerts" taxpayers, their representatives, and *organizers and sellers* of such transactions to responsibilities that may arise from "participation" in these transactions, and, most menacingly, warns that "persons who participate in the promotion or reporting of these arrangements will be subject to civil penalties, and, in addition, that anyone who wilfully counsels or advises the evasion or defeat of tax" by such means may be guilty of a criminal offense under myriad provisions of the Code "or other provisions of the federal law."

WILL YOU KNOW ONE WHEN YOU SEE ONE?

The problem of course is being able to distinguish an offensive shelter from a legitimate tax planning design. An abusive scheme will usually come across your desk dressed in the clothes of respectability, often complete with a seemingly comprehensive, albeit specious, tax analysis. The report helpfully points out the three categories into which most shelters fall: (1) the "legitimate" shelters deliberately laid out in the Code by Congress; (2) transactions appearing to fit within the first category by displaying literal compliance with the statutory design, but suspect for pushing beyond the intended limits to yield tax effects unwarranted or inconsistent with the underlying statutory policy; (3) transactions designed and sold aggressively in reckless disregard of Code provisions that, under any reasonable interpretation of the law, are beyond the pale. One could add a fourth category, the patently "sham in fact" transaction, where the claimed transaction does not even occur, or, if it occurs, is masked to seem like what it is not (e.g., interest paid on a nonexistent debt, or paid and returned to the payor by a concealed route). See, in this connection, Chief Counsel Williams' comment in the above-noted interview: "Taxpayers, at a minimum, have to execute the transaction in conformity with the documents. So, if there were transactions that were just papered over, they were not going to qualify."

The imaginative, computer-literate reader can doubtless add further categories, let us call them "virtual shelters", that exist only in the electronics of the internet at the point where actuality morphs into miasma.

ANATOMY OF A LISTED TRANSACTION

Do you wonder how transactions come to be "listed"? The TE/GE Report graphically describes how one particularly notorious one got picked up. This concerned the scheme to

"season" certain ESOPs whose stockholdings consisted of the stock of S corporations, in order to enable them to take advantage of the delayed effective date of a rule introduced under EGTRRA restricting the allocation of S corporation stock. The device developed by the shelter designer was to form hundreds of shelf corporations-cum-ESOPs for which S elections were made prior to the grandfathered date for making such elections under the statute, and then to sell those non-operating paper corporations to companies established to operate as S corporations. The Service discovered this scam after receiving 300 determination letter requests from a handful of practitioners for ESOPs sponsored by S corporations not conducting any business. Some few determination letters were apparently issued before agents realized what was afoot, at which time TE/GE stopped issuing the letters, and got the Service top brass to identify this ESOP abuse as a listed transaction.

In some cases the identified abuse first shows up in a return or other submission filed with an operating division outside of TE/GE, so the ultimate listing is the result of a cooperative effort between TE/GE and a sister branch. This happened in the case of the listing of the abuse of the 10-or-more plan exemption under 419A(f)(6). Initially the arrangements surfaced on audits conducted by the Small Business/Self Employed division. At about the same time TE/GE was apprised of the abuse "from third-party contacts" (in the protective phrase of the TE/GE Report); and the Service subsequently noted the abuse in a revenue ruling, and still later litigated the issue successfully in Booth v. Commissioner, 108 T.C. 524 (1997) and Neonatology Associates, P.A. v. Commissioner, 115 T.C. 43 (2000), aff'd 299 F.3d 221 (3d Cir. 2002). Finally, the arrangement made the dishonor list in a revenue ruling (Revenue Ruling 2001-15, 2001-1 C.B. 826) and Prop. Reg. § 1.419A(f)(6)-1.

It is no surprise, of course, that the Service's operating divisions share tips. One would hope so. The TE/GE Report confirms that the process of getting a specific transaction listed is "evolving", and involves a team approach. Obviously, any division can suggest a potential abuse for listing. Once the potential abuse has been identified, a collaborative process involving all interested operating divisions occurs. A team is formed to develop the appropriate strategy for dealing with the identified abuse, which may lead to a recommendation to list. Actual listing has the status of published guidance and hence requires sign-off at the highest levels—the Commissioner, the Chief Counsel, and the Assistant Treasury Secretary for Tax Policy.

All these officials have other ways of getting the message across, and have used it effectively. The speaking podium at important meetings of tax and benefits practitioners has been a frequently used locus. The Assistant Treasury Secretary for Tax Policy, Pamela Olson, chose a news release issued—not so coincidentally—on April 15, to state: "The IRS is building an enforcement web to catch and eliminate tax shelters. Taxpayers should come forward now, before they get tangled in the web. The IRS is collecting information about taxpayers and promoters who don't come forward so it can act on that information. It's time to come in from the cold." IR News Release 2003-51.

WHICH **EYE** IS IT?

A quick check of the title of this piece is recommended at this point to better understand the "eye" reference in the caption just above. The TE/GE Report acknowledges that it "is not always easy for TE/GE customers to tell whether they 'participate' in a listed transaction." The Report helpfully cites the passage of the Treasury Regulations informing that a "taxpayer has participated in a listed transaction if the taxpayer's return reflects tax consequences or a tax strategy described in published guidance that lists the transaction", and also "if the taxpayer knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from tax consequences or a tax strategy described in published guidance that lists a transaction." Treas. Reg. § 1.6011-4(c)(3). Of course, listing is a pretty good indication that one is in the red zone, i.e., in a place where it is not only the beholder's eye, but Big Brother's watchful eye that one must reckon with.

Just as this issue was going to press, the Service added to its dishonor "list" the notorious intrafamily, nonstatutory, stock option assignment transaction that had figured prominently in the dismissal of the two principal Sprint executives last February (Notice 2003-47), and amended the section 83 regulations to take such arrangements outside the timing rule of that section (TD 9067, adding Reg. § 1.83-7T as temporary and proposed regulation). The listing process can be expected to grow apace. The fact is, however, that the "list," if growing, still only spotlights a small segment of the shelter universe. While the list expands arithmetically, one by one, the shelter offerings expand geometrically. The newspaper accounts and the tax periodicals provide a better picture of shelter products, mostly unlisted, but generally only after they have been attacked in high-profile settings. No one who reads the papers can be unaware of the storm; and that in itself is doubtless cleansing the marketplace, or at least acting as a kind of *cordon sanitaire*. A Wall Street Journal headline several months ago suggests, though, that abusive shelter interruptus will be only a temporary aberration: *Tax-Shelter Sellers Lie Low For Now, Wait Out a Storm* (2/14/03) [by Cassell Bryan-Low and John D. McKinnon]. That remains to be seen.

THE **FITTING** PUNISHMENT

It will not be conscience alone that makes cowards of the more aggressive promoters. As shelters have proliferated so have the penalties, civil, criminal and ethical. The TE/GE Report recites the major provisions of the tax law and

SEE **SPECIAL REPORT**, PAGE 24

POINTS TO **REMEMBER**

Editor's Note: POINTS TO **REMEMBER** are individual submissions to the *NewsQuarterly* from Associate Editors and 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 views 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.

COST RECOVERY RULES FOR SOFTWARE: ENTERPRISE RESOURCE PLANNING SOFTWARE AND EVOLVING BUSINESS MODELS

by David S. Davenport and E. Kelsey Lemaster, Boston, MA

INTRODUCTION: THE CURRENT COMPUTER-DRIVEN BUSINESS MODEL

Since the development of the first business computers, computer systems and software have quickly become a ubiquitous medium through which business operations may be organized, mechanized, and accelerated. In recent years, however, many businesses have reached a point at which their business systems and software have grown overly complex and less efficient. In response many companies are turning to higher-level software systems, or meta-systems, whose primary function is to organize and manage all of the other systems and software for a single business or business unit. These systems are often large capacity software shells that contain general integration features and functionality but require significant customization for each purchaser.

In connection with the purchase of a meta-system, the purchaser typically hires a consulting firm to perform necessary installation and customization work. Although the costs of purchasing, installing, and customizing a meta-system are often substantial, many of these costs can be recovered for tax purposes over relatively short periods of time. With respect to some types of costs, taxpayers may have considerable flexibility to choose their method of recovery. With respect to other costs, however, significant questions remain as to how taxpayers are to classify such costs (e.g., as either development or acquisition costs) and recent guidance issued by the Service has produced considerable controversy.

In a recent private letter ruling the Service addressed the classification and treatment of installation and customization work related to the acquisition of a popular form of meta-system, "enterprise resource planning" (ERP) software. PLR 200236028 (Sept. 6, 2002). In that PLR the Service concluded that some of the installation and customization work would be treated as part of the acquisition costs that were not eligible for expensing as software development costs. PLR 200236028 gained a higher and more controversial profile when the preamble to the proposed "INDOPCO regulations" stated that the Service and Treasury "expected" final regulations to address the treatment of ERP costs and to treat such costs in a manner consistent with the PLR. At the same time, the Service indicated that the distinction between acquisition costs and development costs would be the subject of separate future guidance, and would not be addressed in the final INDOPCO regulations. The classification of costs related to the acquisition and implementation of meta-systems like ERP is therefore not only a key cost recovery issue, but one that is in serious need of further clarification.

THE CURRENT ADMINISTRATIVE GUIDELINES: REVENUE PROCEDURE 2000-50

With Rev. Proc. 2000-50, 2000-2 C.B. 601 (successor to Rev. Proc. 69-21, 1969-2 C.B. 303), the Service restated a framework of cost recovery rules for software development costs, acquisition costs, and license or lease costs incurred by a taxpayer. For purposes of Rev. Proc. 2000-50, computer software is defined as "any program or routine (that is, any sequence of machine-readable code) that is designed to cause a computer to perform a desired function or set of functions." This definition also includes any related documentation required to describe and maintain the program, and any media on which the program is stored.

Generally, for each type of cost incurred with respect to software, Rev. Proc. 2000-50 provides that the Service will not disturb a taxpayer's treatment if the taxpayer utilizes certain prescribed cost recovery methodologies. Rev. Proc. 2000-50 is expressly inapplicable, however, to (i) any acquired software subject to 15-year amortization as an "amortizable section 197 intangible" (generally, certain off-the-shelf software and software that is acquired as part of the acquisition of a business), and (ii) any development costs "that a taxpayer has treated as a research and experimental expenditure under section 174."

For software *development* costs, Rev. Proc. 2000-50 provides that taxpayers may choose either to deduct the costs in the year they are incurred (expensing) or to amortize the costs over one of two alternative periods (either 60 months from the date of completion of development, or 36 months from the date the software is placed in service). Effectively, the taxpayer may make the choice to deduct or amortize only once, as Rev. Proc. 2000-50 requires taxpayers to recover *all* software development costs consistently under one of the two recovery options.

For software *acquisition* costs, Rev. Proc. 2000-50 provides that taxpayers may amortize separately-stated software costs over a period of 36 months in accordance with the rules of section 167(f)(1) (governing software that is

not a section 197 intangible)[1] and may amortize other software costs that are included in the costs of accompanying hardware (i.e., "bundled software") over the same period as the hardware.

Finally, for *licensed or leased* software, Rev. Proc. 2000-50 provides that taxpayers may generally deduct royalty or rental fees under section 162. However, no current deduction is permitted if the amount is properly chargeable to capital account. *Practice note:* whether acquired software is treated as licensed or leased for tax purposes may not be governed by the form of a software transaction (which will typically be documented by some form of license in any event). Instead, the transaction must be analyzed to determine its proper characterization for tax purposes as a license or lease, as a purchase and sale, or as something else (e.g., the performance of services). *Cf.* Treas. Reg. § 1.861-18 (characterization principles for software transactions that implicate international tax provisions of the Code).

DISTINGUISHING DEVELOPMENT FROM ACQUISITION COSTS: THE SERVICE'S POSITION ON ERP SOFTWARE

Although Rev. Proc. 2000-50 provides separate cost recovery rules for software development and software acquisition, it provides no guidance on how to distinguish between the two categories of costs. While the difference between developing and acquiring software may be clear in some situations, many software packages consist of a basic module that is purchased by a business but requires significant customization work, such as writing additional computer code, before the overall package can become functional for the customer. Unlike purchasing an off-the-shelf computer program, installing a complex computer software package may thus involve elements of both software acquisition and software development.

The Service addressed this type of situation in PLR 200236028 (Sept. 6, 2002). The taxpayer sought guidance on the appropriate treatment of costs incurred to purchase and install ERP software, described in the PLR as "a shell that integrates different software modules for financial accounting, inventory control, production, sales and distribution, and human resources." The PLR focused on three general types of costs related to the ERP package: software purchase costs (for the ERP shell), functional consulting costs (primarily training and maintenance costs), and technical consulting costs (as described below). As expected, the Service treated the costs to purchase the ERP shell as software acquisition costs subject to 36-month amortization under Rev. Proc. 2000-50 and section 167(f)(1). The Service also ruled that the functional consulting costs – including those costs paid to train employees on the new software – were deductible in the year incurred under section 162, citing Rev. Rul. 96-62, 1996-2 C.B. 9 with respect to training.

The most interesting of the PLR's conclusions involved the costs which the taxpayer labeled technical consulting costs, and which included amounts paid by the taxpayer to a consulting firm for its work on modeling the ERP software to the taxpayer's business, writing additional computer code, and selecting options and embedded templates from the ERP module to meet the needs of the taxpayer's business. Because the first of these categories (modeling and design costs) was found to relate directly to the work in the latter two categories (writing additional computer code, and selecting options and embedded templates), the Service allocated the modeling and design costs between the latter two categories. The Service then sought to analyze those two sets of costs (enhanced in each case by the allocated modeling/design costs) under the rules of Rev. Proc. 2000-50.

According to the PLR, whether consulting expenses incurred in connection with new software qualify as software development costs or are to be treated as software acquisition costs "depends on the nature of the work performed . . . and on which party was responsible for developing the new software." With respect to those costs involving the writing of machine readable code as described in the PLR, it was clear that the work itself involved the development of software within the definition provided by Rev. Proc. 2000-50, and thus the critical question was whether the taxpayer bore responsibility for the development. The taxpayer's contract with the consulting firm provided no guarantees that the ERP software would function properly and stated that the consultants would be paid (and paid the same fee) regardless of the success or failure of the ERP project. Based on these facts, the Service concluded that the taxpayer was "the sole responsible party for the creation and performance of the software project" and that these consulting costs would qualify as software development costs.

However, focusing on Rev. Proc. 2000-50's definition of software (referring, in part, to "any sequence of machine readable code"), the Service held that the portion of the technical consulting costs paid for option selection and template implementation did not qualify as taxpayer-developed software costs because such costs "do not meet the machine readable code requirements of Rev. Proc. 2000-50." Instead of treating the option selection and template implementation costs as software development costs, the Service treated these costs as software installation and modification costs that were to be capitalized as part of the software acquisition costs.

The general approach to classifying ERP software costs taken in PLR 200236028 was tentatively endorsed by the Service and Treasury in the preamble to the proposed INDOPCO regulations released in December 2002. In an earlier Advance Notice, the Service and Treasury had requested comments regarding the proper treatment of amounts paid to

1. The Jobs and Growth Tax Relief Reconciliation Act of 2003, which increased the section 179 current deduction for depreciable tangible personal property purchased for use in an active business from $25,000 to $100,000, also extends that provision to include certain off-the-shelf computer software (as defined in section 197(e)(3)(A)(i) and (B)) placed in service in taxable years beginning in 2003, 2004, and 2005.

acquire, create or enhance intangible assets, and had expressly solicited "comments on what rules and principles should be used to distinguish acquired software from developed software and the administrability of those rules and principles [under Rev. Proc. 2000-50]." Although a number of comments were submitted, the proposed INDOPCO regulations provide no new guidance for the recovery of computer software costs. The preamble to the proposed regulations states generally that the Service and Treasury "agree [with commentators] that the determination of whether computer software is acquired or developed raises issues that are beyond the scope of these proposed regulations" and that "[t]hese issues will be addressed in subsequent guidance." Curiously, however, despite the reluctance to address the development-versus-acquisition issue, the preamble notes that the final INDOPCO regulations are "expected" to address the treatment of ERP software costs and will treat such costs "in a manner consistent with the treatment prescribed in [PLR] 200236028."

The notion of moving directly to final regulations that treat ERP software costs in a manner consistent with the PLR is controversial. Commentators have noted, among other things, that in many situations the work of customizing and configuring ERP software may be very complicated and may directly relate to additional software development activity and should qualify for deduction under Rev. Proc. 2000-50, or may even qualify independently as section 174 research and experimentation apart from classification as software development costs. A better course would be for the Service to invite comments on the treatment of ERP software as part of a new, broader regulations project relating to the scope of software development and acquisition. As part of such a project, the Service should also consider whether the definition of software in Rev. Proc. 2000-50, at least as applied in PLR 200236028, is too narrowly tied to the writing of machine-readable code.

BEYOND ERP

A number of business technology analysts have predicted that the next generation of business systems and software will come in the form of on-demand IT services. Instead of acquiring stand-alone business computers and software, and hiring supporting technicians, companies would purchase IT power and support on an as-needed basis from other companies that specialize in providing business technology services. Technology would be available to businesses via a grid-type system, which would be operated and maintained by outside firms in much the same way that public utilities and communication systems are currently operated and maintained by their providers.

If the provision of computing and other IT services to customers emerges as a dominant technology model for business operations, the tax law distinction between software development and acquisition costs may become less significant. Instead, the costs incurred by taxpayers for computer technology services presumably will be more akin to software leasing or licensing costs than to development or acquisition costs, and taxpayers may be able generally to deduct their IT costs as they are incurred under section 162 (subject to other capitalization rules, e.g., in the case of prepaid services).

INTERMEDIATE SANCTIONS—RECENT NEW GUIDANCE

by Shannon Nash, Los Angeles, CA

Before Enron, WorldCom, Tyco and Adelphia there was William Aramony of the United Way of America and his lavish trips on the nonprofit's Lear jet—reportedly made to impress his mistress. Executive scandals and exhorbitant spending sprees were becoming common in the world of nonprofit organizations. Because such organizations are public entities whose funds are supposed to be used to benefit the public, and not just a few private individuals, reforms were called for.

The intermediate sanction legislation, which is the subject of this piece, was enacted in 1996 as a way to curb abuses by executives of exempt organizations who were benefiting personally from private transactions with the organization. Prior to the enactment of the intermediate sanction legislation, the Service's only recourse when faced with executive abuse was to revoke the tax-exempt status of the organization. The severity of the sanction led the Service to invoke it infrequently and thus hampered its enforcement efforts. With intermediate sanctions, the Service can punish those who improperly benefit from the transaction without jeopardizing the exempt status of the entire organization. The result has been more vigorous enforcement on the part of the Service and that means that the rules that govern the conduct of individuals connected with exempt organizations are no longer of concern solely for the exempt organization specialist. Every attorney who serves on a board or helps her neighbor with her small nonprofit organization needs to know these rules.

Under these rules, penalty taxes are imposed any time a section 501(c)(3) organization (other than a private foundation), or a section 501(c)(4) social welfare organization, pays an excess benefit to a disqualified person. An excess benefit transaction is one in which a disqualified person receives an economic benefit that exceeds the value of what the exempt organization received in return. A disqualified person is any person or organization that was in a position to exercise substantial influence over the affairs of the organization at any time during the five years ending on the date of the transaction in question (e.g., members of the board of directors, the executive director, family members of such persons, etc.).

The penalty tax is imposed on and paid by the disqualified person and by the organization's managers (officers, directors, trustees and other persons in the organization with similar powers or responsibilities) who knowingly approve or otherwise participate in the excess benefit transaction. A first level tax equal to 25% of the excess benefit amount is imposed on the disqualified person. If the disqualified person does not correct the excess benefit transaction promptly, there is

an additional tax of 200% of the excess benefit amount. In addition, an organization's managers may be subject to a tax of 10% of the excess benefit amount, up to a total tax of $10,000 per transaction. All organization managers who participate in the transaction are jointly and severally liable for the tax.

Nevertheless, there is some relief for taxpayers who may be subject to these rules. Under a so-called "rebuttable presumption" provision, if a "safe harbor" procedure is followed, the burden or proof shifts to the Service to demonstrate that the economic benefit to the disqualified person was in fact unreasonable. The rebuttable presumption has the following three requirements:

1. The transaction must be approved by the organization's board of directors or other appropriate governing body or committee, provided that this board or committee is entirely disinterested (i.e. that no member of the board or committee has a conflict of interest with respect to the transaction);

2. The board or committee must obtain and rely on appropriate comparability data in approving the transaction; and

3. The board or committee must document the basis for its determination concurrently with making the determination.

The intermediate sanction rules are codified in section 4958 and the regulations were finalized on January 23, 2002. Now, several years after section 4958 was first enacted, the Service has won a partial victory in an intermediate sanctions case and has issued several private rulings. The time is therefore ripe for reviewing the scope and import of these rules.

INTERMEDIATE DECISION—*CARACCI*

The Tax Court handed down the first ruling testing the intermediate sanctions rules in *Michael T. Caracci et ux., et al. v. Commissioner*, 118 T.C. No. 25 (May 22, 2002). This case involved three nonprofit, tax-exempt home health agencies in Mississippi—known as the Sta-Home Heath Agencies—that were set up and operated by the Caracci family.

For many years these home health agencies were operated as nonprofit organizations because Mississippi law so required. Nevertheless, after years of operating at a loss, the Caracci family determined that they would have better access to capital markets and be in a better position to benefit from reforms taking place in the health care industry if the organizations changed their status and became a for-profit corporation. The Caracci family consulted an attorney and obtained an appraisal from an accountant who concluded that the organizations had negative net worth. Subsequently, the assets of the organizations were transferred to a for-profit corporation, which also assumed the liabilities.

The Service challenged the accountant's negative valuation and concluded that in fact the organizations' assets exceeded the assumed liabilities by some $20 million. The Service then charged the directors and officers of the organizations—mainly the Caracci family—with receiving excess benefits due to the low valuation, and assessed intermediate sanction penalty taxes. The Service also sought to revoke the organization's exempt status.

The Tax Court agreed with the Service—at least partially. Judge David Laro ruled that the organization did have a positive net worth and that the Caracci family had failed to take into account the value of the intangible assets, such as the value of state certificates that allowed the family to operate home health care services. The Tax Court ultimately concluded that the net assets were worth $5 million—and, hence, that the family received an excess benefit in that amount. This resulted in a $1.25 million penalty tax for the Caracci family as disqualified persons and in the imposition of the $10,000 penalty tax for organizational managers.

Nevertheless, the Tax Court did not agree with the revocation of the organization's tax-exempt status. Significantly, the Tax Court stated that it would be unusual to find that both imposition of intermediate sanctions and revocation of an organization's exempt status were warranted.

The Caracci family does not yet have to pay the penalty taxes because the case is currently on appeal to the Fifth Circuit. Even if the family loses on appeal, it can avoid the penalty if it corrects the problem by returning the $5 million to the Sta-Home Health Agencies. Moreover, earlier this year the Service decided to drop its appeal of the revocation of the organization's exempt status.

INTERMEDIATE RULINGS—THE SERVICE SPEAKS

A pair of recently issued private rulings provide important insight into the Service's application of the intermediate sanction rules. In TAM 200243057 (July 2, 2002), the Service ruled that a used car salesman who established a tax-exempt organization to accept donations of used vehicles, received numerous excess benefits, as determined under the intermediate sanction rules.

The Service found that certain loans to the taxpayer from the exempt organization were excessive. There was no written loan agreement, fixed maturity date, or repayment schedule. The Service explained that it was as if when the taxpayer needed money (e.g., to purchase property), he merely wrote a check from the exempt organization's bank account and labeled it "loan payable." The Service was also troubled by certain payments that benefited the taxpayer's family. For example, the exempt organization paid to repair cars that were driven by the taxpayer's family members. Finally, the Service deemed the taxpayer's salary excessive. There was no evidence of the number of hours the taxpayer worked, the type of services that he provided or that his salary was reasonable in light of comparable salaries. In addition, there was almost no written documentation to show that the organization's board of directors approved many of these transactions. In the end, the Service found that all of these activities were excess benefit transactions.

SEE **POINTS**, PAGE 21

POINT & COUNTERPOINT:

SHOULD EXPERIENCE IN TAX PRACTICE BE A PREREQUISITE FOR A POSITIVE TAX SECTION RECOMMENDATION FOR APPOINTMENT TO THE U.S. TAX COURT?

INTRODUCTION: The outgoing Chair of the Section of Taxation, Herb Beller, has spoken several times in recent months about the topic for this month's Point-Counterpoint. The issue, broadly stated, is whether prior substantive tax experience should be considered a prerequisite for an appointment to the U.S. Tax Court, or more narrowly, whether such experience should be required before the Section's Committee on Appointments to the Tax Court gives a positive recommendation to a nominee. As Herb has indicated, there is no consensus on this issue within the Section or even within that Committee.

Therefore, we asked two tax academicians to weigh in with some arguments on both sides of this issue. Michael Mulroney, of Villanova University Law School, asserts in the Point below that tax experience is less important than other criteria for being a good Tax Court judge. Bryan Camp, of the Texas Tech University Law School, argues in response that both the appearance and reality of tax expertise are needed for the Court to participate in the formation of the tax law. — Christopher R. Rizek, Washington, DC

POINT: TAX EXPERIENCE IS NOT NECESSARY

by Michael Mulroney, Villanova, Pennsylvania

Prior tax experience is not a prerequisite to being a good and effective Tax Court judge, and so it should not be a defining qualification for a positive Tax Section recommendation for a Tax Court judgeship. That is not to say that prior tax experience is not a major factor to be weighed, among all others, in arriving at the Tax Section's recommendation; of course it is. But, a nominee's consideration by the Appointments to the Tax Court Committee is not a beauty contest (or a reality TV competition) in which the best is chosen from a herd of contestants. Instead, each nominee is independently scrutinized on his or her own record, without direct regard for the qualifications of other past, present, or future candidates, and designated as well-qualified, qualified, or not qualified. While an important part of that record is the nominee's lawyering experience (tax or not), the presence or absence of tax experience is a factor, but not the factor that should determine the Committee's outcome.

That's because a Tax Court judge is a judge first and a tax specialist second. Over the 15-year term of the initial appointment it matters little whether the tax specialty is learned before ascension to the bench, or afterwards. The most important criterion is whether the nominee appears to have the requisite characteristics that make a good judge.

What are those characteristics? As a general proposition, the determinant non-political personal and professional factors that lead to a presidential appointment for a judge of any federal trial court have varied at the margin depending on the political party empowered with appointment authority, but at the core they are pretty much the same. They include unquestioned ability and experience in the law, respected professional skill and competence, high moral character and reputation, and sound judicial temperament. To me, the two most important of those factors are professional competence and judicial temperament. According to the ABA Standing Committee on the Federal Judiciary, professional competence includes "such qualities as intellectual capacity, judgment, writing and analytical ability, knowledge of the law and breadth of professional experience." It adds that judicial temperament envisages "compassion, decisiveness, open-mindedness, courtesy, patience, freedom from bias and commitment to equal justice under the law." See ABA Standing Committee on the Federal Judiciary, What It Is and How It Works: Evaluation of Criteria, abanet.org/scfedjud/backgrounder.html (visited May 14, 2003).

"But wait," my opponent will say, "for a Tax Court nominee, doesn't professional competence necessarily mean knowledge and experience of the *tax* law? Gotcha!" Absolutely not, is my resolute reply. The two most pervasive myths perpetuated by the tax profession are the related but wrong-headed—indeed puerile—ideas that tax lawyers are necessarily different from other lawyers, and that tax law exists in a self-contained legal Balkan of its own to be construed and applied without the benefit of correlative law. Each myth has been resoundingly debunked, because there is a necessary and symbiotic relationship between tax and non-tax law, and the latter can be effectively utilized to enrich the former.[1]

If one accepts that proposition, then the non-tax experience of a nominee can become a strongly positive factor. Having said that, I must add that appli-

1. Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow Up To Be Tax Lawyers*, 13 VA. TAX REV. 517 (1994); *see also*, Paul L. Caron, *Tax Myopia Meets Tax Hyperopia: The Unproven Case of Increased Judicial Deference to Revenue Rulings*, 57 OHIO ST. L.J. 637 (1996); Michael Livingston, *Practical Reason, "Purposivism," and the Interpretation of Tax Statutes*, 51 TAX L. REV. 677 (1996) (taxation is not different from other areas of the law).

cation of the proposition depends on all the facts and circumstances (a phrase that has saved many a tax professor from having to give a precise answer to a student's hard question). So, I will readily concede that an outstanding lawyer who has spent his entire 20-year career as a state prosecutor doesn't bring much to my table. But I ask my opponent to concede that an outstanding lawyer who has spent her entire 20-year career in non-tax corporate transactional work brings much.

Even if one does not agree with my proposition, I can still argue persuasively that non-tax experience should not be a bar to approval of a nominee. While understandably a rare occurrence, non-tax lawyers have been appointed to the Tax Court and served there with considerable distinction.[2] A recent study of judicial reasoning in federal tax cases sampled 346 Tax Court decisions handed down from 1979 to 1998, and found two percent of them were decided by judges who had neither prior private practice nor government tax experience. Daniel M. Schneider, *Empirical Research on Judicial Reasoning: Statutory Interpretation in Federal Tax Cases*, 31 New Mex. L. Rev. 326, 332 (2001). So, as a general proposition, non-tax Tax Court judges have long been alive and well and working at 400 Second Street, N.W., Washington, D.C.

The same study tends to lend some support to my postulate that a person who will be a good judge can learn to be a good tax judge after she ascends the bench, in part because of the nature of the cases that come before her, and in part because of the kind of analytical approach applied by Tax Court judges to those cases. So, of the cases sampled over the 20-year measuring period, the largest number (38%) dealt with individual tax questions, 16% involved procedure, 14% were business tax matters, and the remainder of the cases (generally involving more complicated areas of the tax law) were in single-digit percentages. That, coupled with the fact that (I understand anecdotally) brand new judges tend to be assigned S case trial calendars (sometimes to their quiet dismay), means the initial learning curve is not necessarily unreasonably steep.

Further, the study points out that 60% of the Tax Court cases sampled were decided on the basis of what one author termed practical reasoning: that is, decisions rendered by other courts and "opinions that were relatively unstructured and practical in their approach, as opposed, for example, to a court that relied solely on [the more technical] regulations or on legislative history." If that is so, my hypothetical highly experienced non-tax transactional lawyer shouldn't have too much difficulty in making her way as a Tax Court judge, from the outset.

Finally, the misguided notion that prior tax experience is a prerequisite for a Tax Court judgeship naively disregards the fact that there are a whole bunch of federal judges out there who have no prior tax experience whatsoever, but to whom we tax lawyers eagerly entrust our clients' refund suits and to whom we appeal when the Tax Court holds against us. Memory brings me the names of only a few judges with tax backgrounds who sit on non-tax federal benches: for instance, Reginald Gibson of the Court of Federal Claims, Marvin Garbis in the District of Maryland, and Cynthia Holcomb Hall of the Ninth Circuit. While I'm sure there are more, I'm also sure there aren't many more. And yet non-tax federal courts with generalist judges routinely handle complex tax cases and bring them to successful conclusions.

"OK," my opponent will respond, "but wouldn't the appointment of admittedly high quality non-tax lawyers to the Tax Court tend to dilute the aura of special tax expertise with which reviewing courts enshroud Tax Court decisions?" There are two answers to that. First, if you *lose* in the Tax Court, do you really want to be faced with that perception on appeal? Second: What aura?

The idea of special deference to the Tax Court on legal questions was probably spawned—or at least fertilized—by the Supreme Court's statement in Bingham's Trust v. Commissioner, 325 U.S. 365, 370 (1945), that a "decision by the Tax Court is entitled to great weight." Appellate courts had considerable difficulty with that idea, e.g., Brooklyn National Corp. v. Commissioner, 157 F.2d 450, 453 (2d Cir.1946), and eventually came to disregard it. *See, e.g.*, Commissioner v. Hendrickson, 873 F.2d 1018, 1022 (7th Cir. 1989). Thus, my opponent's concern is unfounded.

In sum, in all events a Tax Court nominee should be an experienced lawyer with demonstrated balanced judgment and, while extensive tax experience is desirable, it should not be a prerequisite to a favorable rating by the Appointments to the Tax Court Committee. Any other approach unacceptably diminishes the stars in the universe of good, seasoned, experienced lawyers who have the potential to be nifty Tax Court judges, and unacceptably limits the approach to too narrow a constellation of potential nominees of the tax-practitioner persuasion.

COUNTERPOINT: TAX EXPERIENCE IS NECESSARY

by Bryan Camp, Lubbock, Texas

Substantial tax experience should be necessary (but not sufficient) for appointment to the Tax Court for reasons of both appearance and substance. The reasons of appearance rest on the view that the Tax Court engages in a meta-level conversation with the other constitutional participants in our system of laws. The reasons of substance rest on the view that tax law really is different from other areas of law and the Code is best

2. I guess it's time to disclose my bias. I clerked for a Tax Court judge, John E. Mulroney, who had no tax experience prior to his appointment to the court. While I was there he held the court's informal record for the number of opinions produced annually (about 60) and for the lowest rate of appellate reversals. "The many opinions he wrote...contributed greatly to the development of Federal tax law.... In sum, he was one of the most experienced Judges ever to have been appointed to [the] Court... He brought to the...Court the benefit of his wide and varied legal background." In Memoriam, 72 T.C. ix, xii (Scott, J.), xvi (Irwin, J.), xvii (Wiles, J) (1979).

interpreted by judges who have a working knowledge of the structure, history and underlying concepts of some significant parts of it, which is what I mean by "tax experience."

An analogy may help illustrate these reasons. I once took a seminar offered by Kent Greenawalt, a leading legal philosopher. The seminar was filled with students who had advanced degrees in philosophy. We delved into works by John Rawls and Thomas Nagle and others of that ilk. But I had a problem: I had never taken a philosophy course. So while others were discussing sophisticated and nuanced glosses on well-known positions and debates, I kept blurting out basic questions about the very predicates of the debates. My questions routinely fell into a well of silence, while some of the very same questions generated excited discussion when asked by someone more credentialed than I. Looking back, I conclude that I did not add much value to the experience of others in the class. First, my lack of experience in these philosophical matters caused others to discount my opinions significantly, regardless of their intrinsic merit, if any. This was a reason of appearance. Second, even though some of my basic questions were also profound, that was accidental, for without the right substantive background I had little ability to discern which comments were shallow and which were deep. Others did. This was a reason of substance.

The Tax Court participates in a perpetual seminar on tax law and tax policy. Through its opinions it engages in a conversation with the other branches of government about both what the law is and what it ought to be. Congress reacts to Tax Court opinions, as do the Service and Article III courts. The work product of each institution affects the work product of the others, resulting in that whole web of statutes, regulations, opinions, and other guidance we call tax law.

Of all these institutional voices, only the Tax Court can potentially speak with the authority of neutral tax experts. Substantive tax experience is not required to serve in either Congress or Article III courts. The Service, Treasury, and tax practitioners may sometimes be, but are certainly not perceived as, routinely neutral. The appearance of the Tax Court as a group of reliably neutral tax experts is necessary to counterbalance the other institutional pressures on the tax system.

Tax expertise is further necessary to counterbalance the Tax Court's status as an Article I court which, for good or ill, cuts against the weight others give its opinions. Put another way, I would argue that Tax Court judges are viewed as tax specialists who become judges because of their expertise. The Tax Court's historical roots as the administrative Board of Tax Appeals supports that view, as does its operation, for the Court less often judges the facts of a case than it does the correct application of the tax laws to stipulated facts.

To be an effective participant in the seminar, the Tax Court must appear to be a voice of expertise. The belief that its judges write from a background of substantial tax experience adds significantly to the credibility of its opinions. To begin appointing judges without a substantial tax background would diminish the Court's voice and possibly even lead to a perception that the judges were appointed more for political patronage and less for their judicial qualifications.

Appearance aside, I think reasons of substance also support requiring tax experience for appointment. I teach administrative law as well as tax. One of the perennial problems in teaching that subject is distilling a coherent set of principles from the myriad organic statutes and agency-specific case law. Administrative law is parochial: each agency and each organic statute create significant variations on the general themes of proper delegation of legislative powers and who between the constitutional players controls interpretations of facts, law, and policy.

Few areas are as parochial as tax law. The interpretive challenge lies not only in the Code's daunting technicality, but also in its overwhelming reliance on the context of enactments and a nuanced understanding of its administrability. Jesse Jackson's polemic that "text without context is pretext" has real bite when applied to the Internal Revenue Code. Scholars from Karl Llewellyn to Bill Eskridge have put the academic gloss on that phrase, persuasively demonstrating that statutes are not interpreted so much by static canons of interpretation (such as "plain meaning" or "orginalism" or "Congressional intent") as they are conceived and reconceived dynamically over time by various communities of interpreters who view the statute through the lenses of their own experience.[1] The Tax Court is an important community of interpreters of the Tax Code, and familiarity with the unique concepts, structure, and actual application of the Code is necessary for the Court to offer wise interpretations for acceptance.

A quick example where substantive knowledge of tax law provides the difference between coherence and incoherence is Compaq Computers v. Commissioner, 277 F.3d 778 (5th Cir. 2001). The panel opinion has been rightly excoriated by others more qualified than I, but what I would point out is how the Court of Appeals panel essentially took upon itself a de novo review of the Tax Court's findings of fact, particularly with respect to the determination of market risk that the taxpayer actually undertook in structuring a transaction to "buy" a foreign tax credit to use against a large capital gain. Among the many distressing features of the panel's opinion is its adherence to the form in which the taxpayer presented the transaction and its disregard for the expertise of the Tax Court

SEE **POINT & COUNTERPOINT** PAGE 22

1. *See* Karl N. Llewellyn, *Remarks on the Theory of Appellate Decision and the Rules or Canons about How Statues Are to Be Construed*, 3 Vand. L. Rev. 395, 401-406 (1950); William N. Eskridge, Jr., Dynamic Statutory Interpretation (Harvard U. Press 1994).

INTERVIEW WITH **GROVER G. NORQUIST**, PRESIDENT, AMERICANS FOR TAX REFORM

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

GROVER G. NORQUIST

INTRODUCTION: Grover Norquist, called "the most powerful unelected official in Washington" by PBS's Bill Moyers, and "one of he most powerful men in Washington" by Paul Krugman on the pages of the *New York Times*, founded his organization, Americans for Tax Reform, in 1985 with the objective of building grassroots support for what became then-President Reagan's Tax Reform Act of 1986. The organization now lobbies for and educates the public on free market principles and policies, and sponsors the Taxpayer Protection Pledge, a written promise between elected officials and voters to "oppose and vote against tax increases." The organization is currently active in virtually every state, and *Fortune* magazine has called it one of the most powerful lobbying groups in America. Mr. Norquist graduated from Harvard University in 1978 and from the Harvard Business School in 1981. He resides in Washington, DC.

Q Can you describe what your organization is doing right now in its efforts to affect federal tax policy?

A Our major ongoing project is the No Tax Increase Pledge. We have 216 members of the House who have signed the Pledge and 43 Senators and one President. So we have got a commitment of no tax increases from them. At the state level, we have 8 governors and 1200 legislators. So we have *Reaganized* the Republican Party on tax policy at the national level. We are in the process of *Reaganizing* the Republican Party at the state level into a No Tax Increase party. Second, in campaigning for the President's tax reduction in 2001, 2002, and 2003, we have gone to state legislators and asked them to pass resolutions instructing their Congressmen and Senators to vote for the President's tax package. We had 27 state legislative bodies do that in 2001. Then we had a large number of them do it also for 2002. We're doing it again this year.

In addition, we went out and asked States to pass resolutions in support of abolishing the alternative minimum tax, which is an issue that will come up sometime between now and ten years from now when 30 million people are affected by the AMT. The AMT will go away. I do not know at what point we are going to hit critical mass politically. But I want to be out front when the issue is right. We will learn it is right because people will be complaining on radio talk shows and taxpayers will start being unhappy. But right now, not enough people are hit by the AMT. But we know that day will come because we know how many people will be hit by it 10 years from now.

We are also working to make death tax repeal permanent. One goal of these resolutions is to start teaching state legislators how to be involved in national issues. We want to get publicity in South Dakota for the fact that the South Dakota legislature wants most of the tax cut and Senator Daschle doesn't. So that's one project line: to support the President's tax cut, get rid of the death tax, and cut the AMT. All of this gets state political people debating national issues.

In another project line we just got letters from 500+ state legislators in support of the President's tax package. Therefore, legislators in Hawaii who can't pass resolutions in support of the President because Hawaii's legislature is overwhelmingly Democratic, get a chance to weigh in. In Maine, I think we have 14 state legislators who wrote in support of the President's tax package. This sends a message to Senator Snowe that she does not represent the state completely. These legislators are making clear that they support the President.

Our next project goal is to get to a single rate tax that taxes income one time at one rate. All income should be taxed once at a single rate. We have a couple of reasons for this. You want to tax income one time—when you earn it or when you spend it. Sales tax or income tax, either is fine. But if the government has to follow you around to tax you when you earn it, when you spend it, when you invest it, when it appreciates and when you die, then the government has to be very involved in your life at many points. If they just have to watch you earn it and steal some, then they can leave you alone. Or when you spend it, they can take a piece of it. But right now, the government has to know all the gold in your teeth because they could have a claim on the gold when you die. So, you want the government to be less intrusive, to tax income one time. One rate is important because in my home

state of liberal Massachusetts, we have a single rate income tax imposed by the state's Constitution. Five times the left has put on the ballot an attempt to move away from a single rate tax and go to a "graduated" or "progressive" rate structure. Five times it has been voted down in a very sophisticated argument.

Some politicians think that voters are stupid. They are not stupid. They say, "I know that the first year you'll cut my taxes and have 12 rates for different people, but over time you'll mug us one at a time." And over time, everyone's taxes will be higher even though some are higher than mine. And the idea of dividing taxpayers into different groups that you then take and mug independently, is the Richard Speck theory of tax increases. That is, if you can't take on everyone in the room at once, you take them out of the room one at a time. So, if everyone is paying the same rate, then your taxes will be lower than if people pay different rates and think that taxes can be raised without hitting them. But of course later, the politicians come back for them. Then the other guys who got screwed while you did nothing stand by and will not help when they come for you. So you want one tax rate.

How do you get there? If you ask who's for a flat tax, Dick Armey and me. That's two people. That's not a political movement. There's no organized effort or lobby to get all the way to a single rate tax other than, if you ask people they'll say "sure, I'm for that." But no one is willing to do anything about it because people are interested in the specific aspects of it and they worry that if they endorse this whole package, their piece will be dropped out of it. So why do they care? You break it into five easy pieces.

First, get rid of the death tax. There is a whole lobby for that. It's the old people lobby, it's the landowner's lobby, it's the asset-rich cash-poor folks lobby and it is the American dream lobby. It is all the 30 year-olds who think that someday they may want to be rich and would have an estate. Even people who don't have an estate. Even people who do not make that kind of money, want to think that if they made that decision, that someone wouldn't take it all away from them. So, the first piece is kill the death tax.

Two, get rid of the capital gains tax. There's a whole series of industries and investors who care about getting rid of the capital gains tax who wouldn't necessarily think it was worth the candle to try and do this whole flat tax thing. But they're a piece of getting the flat tax.

Third piece: a universal IRA. All savings should be tax-free: an IRA, a 401k, portable pension plans and so on. That's the new investor class that cares about that one. When we expanded IRAs and 401Ks in 2001, we had a 400-person vote in the House for it. These were all Democrats screaming, "we do not like the President's tax package." Four hundred House members voted for this piece of it.

Fourth piece, expensing. You see expensing popping up more and more in the discussions of this tax bill and the next tax bill. And the high capital investment industries want that very much in place of long depreciation schedules.

And then lastly, killing the alternative minimum tax. You have those five things and put a single rate on it and you have Dick Armey's or Steve Forbes' flat tax. And that I think is how we get from here to there.

Now there's a second part of the strategy and this is one that we have been working hard on. And that's to get an annual tax cut. You will notice that this Administration has proposed a significant tax cut every year. This does several things. When Reagan was elected in 1981, he came in with a tax cut. K-Street came in, cannibalized it, and took out things he wanted and put other things in. Why? Because they thought, and they were right, there wasn't going to be another tax cut for sixteen years. It wasn't until 1997 that we had another tax cut. Now, that's a career. There are people who moved into this town and died in that 16 year period who were tax people who never got their tax cuts considered, right? Because there wasn't a tax cut vehicle. There was tax reform in 1986 and there were tax increases but no tax cut. Bush has a tax cut every year. What does that mean? Several things.

The White House set up the Tax Relief Coalition. It includes the major trade associations in America and Americans for Tax Reform. And we sit around and all agree, Chamber, NFIB, NAM, hotel distributors, retailers, restaurateurs; we all agree to support the President's tax bill, even though in 2001, there was nothing for the business community in that tax bill. Why? Because there will be a tax cut every year. And the best way to be in next year's tax cut, and to recommend yourself and your interest and your tax cut for next year's tax cut, is to be a pal and helpful on this year's tax cut. And people that sit on the side and whine and complain and do not like this year's tax cut, go to the end of the line when it comes time to plan next year's tax cut. And you know, if you do not make it in next year's, because 2002 is a smaller tax cut than a lot of us would have liked, there's always 2003. And if you do not make it in 2003…this is why I do not sweat the small stuff…what do I care if my preferred taxes…..I would have been an expenses person rather than a get rid of double taxation and dividends person if I'd been writing it. But I would have done the other next year. And so we do double taxation of dividend income this year, we do expensing next year. That's cool. Everybody can be patient. If this is the last plane out of Casablanca, people have very sharp elbows and little old ladies get pushed onto the tarmac. But if there is a bus every 20 minutes, you say, go ahead, I'll take the next bus. So an annual tax cut is a hugely important strategic tactic of the Bush Administration and the tax cut effort. What you do with that is you also create pent-up demand for future tax cuts because everyone sees this promise of a tax cut every year. And then they take all their ideas off the shelf and they start shopping them and they pro-

mote them to congressmen and senators. So there are dozens of congressmen and senators with different tax cut ideas. The five I listed and then a bunch of other things. If I do not get into this year's bill, I'll circle around for next year. We could fill the next 10 years with tax cuts and not run out of the ideas that people are already putting forward. So announcing a tax cut every year brings people out of the woodwork to work for their favorite tax cuts. And it creates a pent-up demand for tax cuts.

So these are the strategies on how to keep moving towards a single rate tax, tax income one time, maintain the momentum for tax cuts, build support for it at the state level, keep the business community unified and not divided. What Mae West said about sex… it's true about tax cuts; all tax cuts are good tax cuts. Even bad tax cuts are good tax cuts. So don't sweat the small stuff. Cut taxes every year. Then keep coming back with new ideas.

Q You were on the IRS Restructuring Commission. Tell us about the work you did and the changes you've seen as a result of it.

A They made some minor improvements. They made the IRS a little more consumer friendly, a little less abusive. It didn't have a big success that I could point to. My disappointment was I couldn't get them to focus at all—because Senator Kerry was co-chairman—on the politically targeted audits.

During the Clinton years, the IRS was auditing the National Rifle Association, Citizens Against Government Waste, Heritage, every right-wing group you can think of. (And I was in the papers at the time complaining about this and a lot of people assumed they were also auditing ATR. They never did and I assume they didn't because I was on the Commission.) They hit a lot of groups with audits just to take up their time. They literally parked someone in your office for a year or two and then sat and whined at you. Some lady complained about Bill Clinton picking on her. She got audited. I thought that was a problem. I was assured by the head of the IRS that it wasn't a problem and that I could take their word for it. I did say, "Look, I've talked to all my left of center friends…they are not getting audited." This is not like you are deciding to audit political groups or something. All the right of center groups are getting audited and I think it smells. I still think it stinks and I think it is something we need to be worried about.

Along those lines, ATR has worked with the Treasury Department to come up with an explanation of the rules for churches, synagogues and mosques. Every year the Americans United for Separation of Church and State sends an insulting letter to most ministers in the country and says "if you talk about politics, the IRS will come in and take away your tax deduction." So Treasury came up with a "here are the rules." It's 26 pages. It is still too long, it is still too complicated and it is not clear enough. So, they're working on it, but we need to get that out so that churches, synagogues and mosques can know what the rules are. Where is the line? What can you do? You can say, "I'm voting for Bush." You can't say, "This church endorses Bush." Lay people need to know the rules, so that when they get the nasty letter they can say, "Well, here's what the IRS says the rules are."

There's also legislation that Walter Jones is putting forward which goes beyond codifying the present IRS regulations and rules and goes to, basically, saying churches can do anything they please when it comes time to talking about anything. They have First Amendment Rights and you can't take away their First Amendment Rights. Basically it is saying all churches can operate the way some churches operate at present, but so can conservative churches. I think that would be helpful because the IRS does not jump in on certain churches that do endorse. I have attended churches when they made explicit political statements. Everyone should have the same rules. I think the Walter Jones legislation is a good idea and it protects the churches to continue to speak out without legal liability.

Q If a goal is to eliminate double taxation on dividends, one other approach that we have not heard about is to simply give corporations a deduction for dividends paid. Why not take that approach?

A Two things. It evidently costs more if you do it that way. So it is better, but it could cost more.

Second, this was the first investor class tax cut that specifically recognized that most Americans are now investors. Seventy percent of the people who voted on Election Day on November 5, 2002, own shares of stock through IRAs, or 401Ks, or directly own stock. There are more voters who own shares of stock than have full-time jobs. Fifty-five percent of voters have full-time jobs. Seventy percent owns shares of stock. The way to make it clear that this was an investor class tax cut was to have the incidents of the tax cut obviously on the investors.

It is like when you cut property taxes on landlords. It will reduce indirect taxes on tenants, but tenants do not necessarily think they're going to see it. But if you make clear the connection, that's better politically

Also watch in the future for growth of the investor class. The biggest demographic change in the last twenty years in America is not the number of people whose parents speak Spanish. It is the number of people who own shares of stock; twenty percent in 1980, over fifty percent of households today, so about sixty plus percent of everybody and seventy percent of voters. A huge chunk. And this has changed the tax debate. Gephart used to stand up and say, "I'm going to steal money from the big corporations and give everyone in the room a dollar." And in the 1960s, ninety percent of the people in the room got a dollar and ten

SEE **INTERVIEW** PAGE 23

SPOTLIGHT ON COMMITTEES: REAL ESTATE COMMITTEE

by Michael J. Grace, Washington, DC

"A mile wide and an inch deep" aptly describes the Real Estate Committee, at least when compared to many other Committees within the Tax Section. Provisions from virtually every subchapter of the Code affect real estate. The Real Estate Committee responds to this reality in two ways. First, in addition to having primary responsibility for particular Code provisions, as is usual, the Committee also has secondary responsibility for many other provisions. Second, the Committee typically covers a broad range of topics in its three meetings each year.

COMMITTEE PROGRAMS. The Committee presents programs on various topics, many beyond those traditionally associated with real estate. For example, at the May 2003 Meeting in Washington, DC, the Committee's programs included a panel on "Hot Topics in Real Estate Taxation," which highlighted recent developments concerning like-kind exchanges, real estate investment trusts, and other real estate transactions. Another panel analyzed recently issued regulations on gains from selling principal residences. In addition, two panels addressed transcendent topics. One such panel analyzed the ways in which eliminating the double taxation of corporate income might affect choice of entity and other structural choices, including the use of REITs, tax credit programs, and foreign investment in U.S. real estate. Unwittingly testifying to the timeliness of the panel, Congress several weeks later reduced tax rates on dividends and capital gains when it passed the Jobs and Growth Tax Relief Act of 2003. A panel on "Attorney-Client Privilege and Other Sensitive Ethical Issues in Transactions and Litigation" alerted real estate tax advisors to increasingly complicated ethical issues under the attorney-client privilege and the tax advisor privilege codified in section 7525.

Panelists and speakers at the May 2003 Meeting included many tax lawyers currently serving in Government, including Helen Hubbard, Treasury Tax Legislative Counsel; B. John Williams, Chief Counsel of the IRS; Cecily Rock, Senior Legislation Counsel, Staff of the Joint Committee on Taxation; and Emily Parker, Deputy Chief Counsel—Operations, IRS. Panels at previous meetings have presented programs on "Real Estate Tax Shelters," "Estate Tax Phase-Out and Repeal: What It Means for Real Estate Tax Lawyers," and "What Tax Lawyers Need to Know About Securitized Real Estate Financing Transactions."

COORDINATION WITH THE PARTNERSHIPS COMMITTEE. The Real Estate Committee works very closely with the Partnerships Committee. Among other things, the two Committees alternate meeting slots (mornings and afternoons) on Fridays. Between the morning and afternoon meetings, members of the two Committees meet for lunch with a speaker, typically from Government. The two Committees also coordinate their meeting agendas because many developments in the taxation of partnerships significantly affect real estate. Periodically, a particularly significant topic will be covered in two separate programs in the morning and afternoon sessions.

A unique feature of the relationship between the two Committees is the "shop talking" breakfasts. Held each Saturday morning following the Friday Committee meetings, these breakfasts (ticketed events) generally have no agenda or scheduled speakers. Instead, in an "open mike" format, attendees spontaneously raise technical issues and share ideas and war stories. The shop-talking breakfasts attract members of many other Committees.

The two Committees also coordinate social activities. Each Thursday evening before the Friday Committee meetings, members, guests, and friends of the Committees gather for cocktails followed by dinner. These gatherings anticipate the next day's intense agenda of continuing education programs, and socializing generally supplants technical discussion.

Finally, the Real Estate and Partnerships Committees collaborate annually in paying courtesy visits to Government officials. On the Thursday preceding each May Meeting, officers of the two Committees visit with tax staff on Capitol Hill (Joint Committee on Taxation, Senate Finance Committee, and House Ways and Means Committee), and tax professionals at the Internal Revenue Service's National Office and at the Treasury Department. Ideas for continuing education panels and comment projects frequently emerge from these meetings.

SUBCOMMITTEES AND COMMENT PROJECTS. As a result of its broad jurisdiction, the Real Estate Committee has many subcommittees. Subcommittees focus on particular specialties within real estate taxation, including like-kind exchanges, REITs, leasing, tax credits, and estate planning. The Committee wants to increase its output of comments, especially comments suggesting transactions or issues that the Service might address in revenue rulings or other "one-off" guidance. Anyone interested in joining a subcommittee or working on comments should contact the Committee's incoming Chair, Steve Berman, or one of its Vice-Chairs, Jim Lowy and Kevin Thomason. ■

REMINDER: Section members may apply to join committees with the online *Committee Preference Form* at www.abanet.org/tax/groups/comember.html. You will need your eight-digit ABA member ID number and your password (usually your last name) to access the form. If you do not know your ID number, contact the ABA Service Center at service@abanet.org. *One Committee Rule*: As of July 1, 2001, the Section rescinded its *One Committee Rule*. Section Members now may join as many committees as they like.

PRO BONO AWARD RECIPIENT: PETER LOWY

On Saturday, May 10, at the Section's 2003 May Meeting in Washington, DC, Peter Lowy became the second recipient of the Section's annual Pro Bono Award. The Section's Pro Bono Award is presented each year to an individual lawyer or law firm who has demonstrated outstanding and sustained commitment to *pro bono* legal services, particularly with respect to federal and state tax law. Peter Lowy, a senior tax attorney with the Shell Oil Company in Houston, received the award in recognition of his extensive *pro bono* work, including his assistance in establishing the first low-income taxpayer clinic in the Houston area. In addition to his work with the low-income taxpayer clinic, he has served as a mentor to other tax lawyers through the Houston Volunteer Lawyers Program and is developing a nonprofit website for low-income taxpayers (www.taxpayerrights.org). His commitment to *pro bono* services runs deep, as he also serves as co-chair of the Pro-bono Committee of the Houston chapter of the American Corporate Counsel Association. The Section is proud to have Peter Lowy as one of its members and to be able to honor his substantial *pro bono* work in this way. ■

PETER LOWY

POINTS

FROM PAGE 13

In TAM 200244028 (July 21, 2002), the Service focused on an area that is ripe for the application of intermediate sanctions—executive compensation. The TAM involved compensation paid to a nonprofit health care organization's CEO and his wife under a post-employment consulting agreement. The Service first concluded that the CEO and his wife were both disqualified persons. The Service also held that the consulting agreement was a binding written contract and that an amended consulting agreement constituted a new contract.

This TAM also sheds light on the rebuttable presumption of reasonableness. The Service agreed that the first and third requirements of the rebuttable presumption were met—namely, that a disinterested authorized body approved the compensation package and adequately documented this. However, the Service concluded that the second requirement was not met. Although the authorized body—a personnel committee—did review comparability data provided by an executive compensation consultant that was hired by the organization to help in establishing that the couple's compensation was reasonable, this data came some nine months after the effective date of the consulting agreement. Moreover, the same data was used when the consulting agreement was amended some five years later.

In its most recent ruling, PLR 200247055 (November 22, 2002), the Service looked at whether a free bus service run by a hospital resulted in excess benefit transactions for the hospital's physicians. The hospital, serving several municipalities and rural communities, wanted to purchase a bus that it could use to pick up patients who needed transportation for rehabilitation and for other medical services, including transportation to doctors' offices. The free transportation would be on a first-come, first-served basis. Although several of the doctors served on the hospital's board of trustees, none would have a financial interest in the bus transportation system.

The Service ruled that because the bus service would be equally available to all patients of all physicians, the fact that disqualified persons—namely, the doctors on the board—might derive what the Service described as an incidental benefit from the operation of the bus service, did not mean that the bus service created an excess benefit for them.

INTERMEDIATE LESSONS

There are some important lessons to be learned from each of the cases and rulings discussed above. From *Caracci,* the lesson is that getting a valuation is not enough. The valuation should conform to appropriate industry standards. Also, it couldn't hurt to get a second or third appraisal. TAM 200244028 adds that valuations are not only crucial but also should be used contemporaneously with making a decision that the transaction is reasonable. TAM 200243057 points out that dealings should be arms length and all exempt organizations should adopt and abide by a conflict of interest policy. Since issuing this TAM, the Service has pointed out that the TAM highlights how these penalty taxes can stack up. The original amount of all of the excess benefits was $300,000. However, after stacking the intermediate sanctions penalty taxes, the total tax bill here could be well over $1 million. Finally, PLR 200247055 demonstrates that all benefits that disqualified persons derive are not created equal. Incidental benefits, those that don't rise to the level of excessive, will not be subject to the intermediate sanction rules.

Although these cases and rulings are helpful and show that the Service is taking these rules seriously, they only scratch the surface of the myriad places and ways that they might be applied. Everyone in a position of authority in an exempt organization needs to know about them, and we can look forward to further guidance from the Service on how the rules apply. ■

POINT & COUNTERPOINT

FROM PAGE 16

in finding the substance behind the form. I explain this more and give other such examples elsewhere.[2]

That a generalist Court of Appeals overturned the specialist Tax Court in Compaq may seem to cut against my argument that substantive tax experience matters, but I think actually supports it. My argument is not, indeed cannot be, that the Tax Court either (a) "gets it right" all the time or (b) is always respected and never reversed. My argument is that the Tax Court is a voice in the ongoing conversation between the constitutional participants in the evolution of the tax law. That voice must not only appear to be expert (which I argue above) but must also actually be expert in order to offer persuasive readings and interpretations of the Code, even if those are later overturned by a misguided higher court or Congress. Expert opinions show the possibilities that readers can then measure against other possibilities to provide a richer debate on tax law and policy issues

Professor Mulroney offers some cogent arguments in favor of his position, which I would be remiss to neglect. I think his two best are: (1) it is a "myth" that tax law is self-contained; and (2) generalist judges appointed to the Tax Court can learn on the job because most of the Court's cases are relatively non-technical in nature and can be decided by "practical" reasoning.

As to the first, I agree that tax law shares legal concepts with other areas of law. To say that, however, does not deny that tax law is also different: a detailed and sophisticated set of rules overlaying some fundamental unwritten concepts such as tax base and basis. For example, the tension between form and substance occurs in all areas of law. But deciding what is form and what is substance in tax is indeed, I would argue, a unique exercise in decisionmaking that requires technical knowledge of the tax implications of various types of transactions. Further, to the extent the "myth" exists, it simply adds support to the reasons of appearance I discuss above.

As to the second argument, Professor Mulroney's point that most cases involve routine matters suggests to me that learning on the job may actually be more difficult than he portrays, because tax law itself involves significant specialization. Even tax specialists who know Subchapter C may not know beans about liens; those who understand the theory and practice of capital export neutrality may be clueless on family limited partnerships. To the extent that "big" cases or complex substantive tax issues are few and far between on the Tax Court's docket, that creates less of an opportunity to learn on the job. My argument is simply that the new Tax Court judge should bring with him or her the kind of experience that would add both the appearance and actuality of value to the conversation.

While I agree that non-tax law experience may be quite valuable, the key is balance. Professor Mulroney's hypothetical outstanding lawyer who has spent a substantial part of her 20-year career in non-tax corporate transactional work might bring much to the table. But I suggest that her knowledge becomes positively dangerous if not coupled with an equally sophisticated understanding of tax law. I do not share Professor Mulroney's concern that limiting consideration of Tax Court judges to those attorneys who have substantial tax experience leaves us with "too narrow a constellation of potential nominees." I am confident that the American tax bar can provide enough candidates who demonstrate sufficient rectitude and other requisite qualities for judicial appointment to fill vacancies as they occur.

Kent Greenawalt is unquestionably a brilliant legal philosopher and truly has all the qualities of a great judge, but just as my opinions did not add much value to his philosophy seminar, neither would his opinions add much value to the tax law, for the same reasons of appearance and substance. This is why one necessary qualification for appointment to a specialized court such as the Tax Court should be substantial experience in its very specialty. ■

2. Bryan T. Camp, *Form Over Substance in Fifth Circuit Tax Cases*, 34 Texas Tech L. Rev. ** (Winter 2003) (critiquing Fifth Circuit tax cases for excessive formalism).

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INTERVIEW

FROM PAGE 19

percent of the people are going to go, "Oh, I'm a shareholder in General Motors and this will hurt me, but maybe I better not say anything because there are so few of us." Today, Gephart doesn't give that speech because if he did, seventy percent of the people would go home and say, "You son-of-a-gun, that's my retirement you're messing with. I hate you." And the other guys who get a dollar go, "Well, I hope to be in the stock market." The only people who aren't intending to be in the stock market are over 75 and not in the stock market. Most younger people not yet in the market intend to buy stock someday.

The other major tax cut that the President is pushing (and it should be thought of this way), is turning the FICA tax into a payroll deduction for your retirement 401K. Instead of paying FICA taxes to the government, turn it into a forced investment program and take twelve percent of my income and make it a forced payroll savings. It is no longer a tax; it is my money. They insist that I save it because they do not want me to show up at 70 and be poor and bleed all over them and ask for subsidies or something. So they say you have to save and when you get to be old, you'll thank us for this.

Q How would current Social Security benefits be funded?

A We will probably do what Chile did. And that is for the government to float a bond to recognize the unfunded liability that already exists. There are several trillion dollars of unfunded liability because there's no money for my retirement because we already paid for my grandma's. You need to recognize that. It is there. It doesn't change the economic status of the United States to recognize that you have this unfunded liability, because the world knows it. It is not a secret. All of the financial markets now take it into account. This cannot continue as is. When Chile did this they borrowed around a trillion dollars to cover all of the old people and phased in young people, saying, "O.K., you now can put your own money into your own account and you're good to go." And they made it voluntary in Chile. They said that if you want to stay in the old system, you could. Then after 10 years they said no, we're tired of the 12 of you that are still in the old system. We are not running this big system for twelve guys, so you have to get in to the new one. But at first it was voluntary and 90 % chose it. And because it was voluntary, it wasn't scary. When you make it voluntary, then I think you do not make it scary. And Bush is talking about a voluntary program.

So that is a huge tax cut because you are turning a tax into a real savings program. And for most Americans the biggest tax they pay is Social Security. And we are going to abolish that tax under the Bush Administration.

Q Who is it in the Administration that is formulating tax policy, because we have had a lot of departures over at Treasury. We hear strong echoes of everything you say in what the Administration is doing.

A The President ultimately. I met with him a year before he started running and sat down with him on a series of issues. We discussed five issues. School choice; he had a history of being for it. Tort reform; he had a history of being for it. Paycheck protection, by stopping labor unions from taking their union dues and spending them on politics. He had not focused on it, but he was for it. The other one I thought was the backdoor way of getting Social Security reform, which was allowing state and local employees in Texas to opt out of the defined benefit pension plan and put their money into a 401K or defined contribution pension plan. He understood it. He endorsed it. He got it passed through one House, the Republican House but not the democratic state Senate. My thought was if he gets that then he would get Social Security Reform. I would never have asked someone who is running for President to endorse Social Security Reform—making it a defined contribution—because that's too much to ask for, right? It turns out he was exactly going to propose that already. I was asking for something that was much less ambitious than he was willing to do. So that was very cheerful.

And then the other one was significant tax reductions and a two-thirds supermajority to raise taxes amendment to the Constitution, which he has endorsed and supported and which we get a vote on every year. He did a letter for us one year endorsing it, which we used for the House and Senate.

So the President gets it. He's very good on the tax issues. President Bush is a post-Reagan president. His father was pre-Reagan. I have a theory that I came to when I was 21. And the theory is that nobody learns anything about politics after the age of 21. They get to be 21, they look around and decide the way the world works and then they go back and run their lives and periodically show up and vote or not. In the history of the United States seven people have changed their politics at age 40 and they've all written books on the subject. David Horowitz is one. But everybody else….You get to 21 and you stay. What that means is Republican politicians can be identified by whether they formed their views pre- or post-Reagan.

You saw Dole…. Dole didn't get it. Bush Sr. sat at Reagan's side for eight years and learned nothing about taxes or policy or anything. He raised taxes and didn't understand what he had done. What happened? He blew his entire Presidency up. Walked right into it and didn't understand that raising taxes is death for a Republican-elected official. Now, we are taking that lesson and driving that down into the states. We're not done yet, but I have about a third of Republican state legislators and about a third of the GOP governors. We are having no tax increases in more states than we are having tax increases, even though this recession is rougher than the 1991

SEE **INTERVIEW** PAGE 26

SPECIAL REPORT

FROM PAGE 9

other federal law under which sanctions can be imposed, as well as the dictates imposed by Circular 230 on those who would practice before the Service. A reading of these guardians of a system that should operate "with integrity and fairness to all" (watchwords of the TE/GE mission statement) is salutary for all. When is the last time you checked them out?

DO CALL US

The Report concludes with its authors' recommendations to the Service's TE/GE Division of ways to make even more effective its assault upon abusive tax shelters, opining that TE/GE "simply cannot curb many abuses audit-by-audit or taxpayer-by-taxpayer," and should instead employ the "wholesale" basis and "try to stop the promoters who are marketing abusive tax shelters to multiple taxpayers." It also recommends the formation of a coordinating "Office of Abusive Tax Transactions," initially acting as a clearinghouse for gathering and passing along leads to the directors of the appropriate TE/GE segments.

Getting down to the nitty-gritty, the Report suggests that TE/GE add an "abuse line" to its phone bank and a "report-abuses-here" link on its web page, thus reversing the old line, "Don't call us, we'll call you." I could suggest an enhancement of this technique: a free cell phone to every caller who identifies a shelter the Service had not heard of. ■

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- Reloading the Real Estate and Tax Law Matrix of Section 1031 Exchanges
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INTERVIEW

FROM PAGE 23

one. Two reasons: in 1991-1992 the people who raised taxes lost in 1993 and 1994. Everyone remembers the big Gingrich sweep in the House and Senate. Oh, and by the way, there were a bunch of Republican governors and six hundred state legislators who won. They weren't being swept in because people were voting for Gingrich to be Speaker. They got swept in because these Democrats had been voting increases because of the 1991-1992 slow down. And the tax hikers lost.

So this time around, some of these guys are the guys who came in in 1995 and are still around. Guys like Pataki. And others are guys who were at least alive and awake and paying attention back then. Also we're a significantly larger organization than we were in 1991-1992. And we have more pledge takers. And I do not need to have everyone in the state take the pledge to stop a tax increase. I just have to have enough to take the Republican Party out of collaborating with any tax increase. So we have stopped tax increases in a bunch of states either with just the governor's say so or with one of the houses saying no. That has been a huge shift.

We will over the next ten years make it impossible for any Republican governor or state legislator to vote for a tax increase, as it is impossible today for a Republican president. The Republican House or Senate will never vote for a tax increase.

People complain about the President not getting support in the Senate on the tax cut. Only four Republican senators voted against him. Forty-six were for him. Everyone in the House was for him. Two of four opponents are pre-Reagan. They're Republicans. They're not liberal. They are older. Their understanding of economics is Richard Nixon's understanding of economics. This is the way that Richard Nixon would behave because that's the generation they come from. Older people retire and move on and are replaced by new people.

And the modern Republic Party is not only not going to raise taxes, it is going to have a tax cut every year. Do that for twenty years and this is a different nation.

Q Is there any limit to tax cuts? In other words, your strategy sounds like a tax cut should occur every year for as long as the Republicans allow it. Is there some limit to what the economy or the government can tolerate in way of tax cuts?

A No, not a practical one.

The Center Right Coalition, and by that I mean the Reagan-Bush Coalition, properly explained, garners 60% of the vote. Our goal as the Center Right Coalition is to drop the cost of government in half in four measures. First, total government spending as a percentage of GDP for federal, state and local purpose is about 33%. We will take it to 16% in 25 years, one generation.

Q A reduction in spending or an increase in GDP?

A This is all reduction of spending. Now, you can do both, but I do not need to presume a giant increase in GDP in order to do this.

If you privatize social security, you've just taken the federal government down by a quarter. So you are half of the way on the federal stuff. You voucherize education: private education costs half of a public education. If public education became as competitive and as productive as private education, you've just dropped half of state and local spending. So it is a number of things. But with 270 billion dollars worth of stuff, you can privatize at the local level from airports to waste water treatment plants and you have a bunch of federal land that you could sell, give away or do something useful with so that the Clinton people do not burn it to the ground, which is what they tend to do with federally owned land out West. Reduce total government employment by half, cut total assets owned by the government in half. There are three trillion dollars in state and local pensions. We want to take those three trillion dollars in state and local pensions—a trillion and a half of which are run by 112 people—and give them to the workers.

Talk about an accumulation of power, one guy in Michigan makes all the decisions for the $100 billion Michigan retirement fund. Twelve guys do the same in California, and the Treasurer of New York does all of New York. There's a huge amount of power in one guy's hand.

You want to break that up and get it in the hands of the 15 million state and local employees. First of all, you turn all the state and local employees into investors and then Republicans. But you also do not want the federal government, state governments or local governments owning $3 trillion. It is crazy. What is this Poland or something in 1956? This is nuts. You need to privatize that pension stuff.

So, four ways to cut the government in half: Spending as a percentage of GDP, regulatory costs as a percentage of GDP, assets owned and government employment. We can take those all in half 25 years from now. Gingrich used to say, "We're going to do this for the next 17 years." And I was always doing everything over 25 years. We were planning on retiring at different times. And the reason I always enjoyed working with Gingrich—and still do—is that you can talk to Gingrich about "over the next twenty five years I plan to do this" and Gingrich would consider this a rational conversation. Most elected officials would say, "Oh, I missed something…twenty-five years?" They do not want to think past the next election. ■

COUNCIL ACTIONS

By N. Susan Stone, Houston, TX and Shannon Nash, Thousand Oaks, CA

The Council of the ABA Section of Taxation met on May 8, 2003, for the May Meeting of the Section at the Grand Hyatt Hotel in Washington, DC. The Council heard reports and took action on the following items.

NEW COMMITTEE NAMES

Mike Hirschfeld, Vice Chair-Committee Operations, discussed the requests by the Committee on Partnerships and the Committee on Regulated Investment Companies to change their respective names to reflect the evolution of the tax law in areas within their jurisdictions. Council considered the requests and unanimously agreed that the Committee on Partnerships would be renamed the "Committee on Partnerships and LLCs," and the Committee on Regulated Investment Companies would be renamed the "Committee on Investment Companies." Also the Agriculture Committee was renamed "Business Cooperatives and Agriculture Committee."

NEW BANKRUPTCY TAX COMMITTEE

Council Director Joe Pari discussed the proposal of the Bankruptcy Task Force to change its status from a task force to a permanent committee. After discussion regarding the scope and jurisdiction of the proposed committee, Council voted to approve the creation of the new "Bankruptcy and Workouts Committee," whose jurisdiction would be Code sections 108 and 1398, as well as all future bankruptcy tax reform acts. Council agreed that jurisdiction over Code section 382(l)(5) and (6) would remain with the Corporate Tax Committee.

NEW MENTORING PROGRAM

Mike Hirschfeld and Wayne Hamilton, Co-Chair of the Diversity Committee, discussed the proposal to create an effective mentoring program that would feature mentoring by Council Directors of members of the Diversity Committee and the Young Lawyers Committee. The purpose of the mentoring program would be for each Council Director to serve as a resource for young and minority lawyers who are Section members to ensure that these lawyers become fully integrated into the activities and opportunities of one or more of the substantive committees chosen by the mentee. Council Director Jerry August volunteered to chair the mentoring program. Council unanimously approved the creation of the mentoring program and agreed that Jerry August should serve as Chair.

ABA TASK FORCE ON CORPORATE RESPONSIBILITY REPORT AND CO-SPONSORSHIP

Paul Sax, Section Delegate to the ABA House of Delegates, discussed

SEE ACTIONS PAGE 28

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ACTIONS

FROM PAGE 27

the report issued by the ABA Task Force on Corporate Responsibility and Section co-sponsorship of such report. The report urges changes in corporate governance policies to create a new culture of corporate responsibility stressing constructive skepticism and active independent oversight of corporate executives. After discussion, the Council unanimously voted to add the Tax Section as a co-sponsor of the report and recommendations.

DISCLOSURE AND LISTING REGULATIONS

Council approved comments developed by the Section's Tax Shelter Task Force on the temporary and proposed regulations under Sections 6011 and 6112. Herb Beller, Chair of the Section, submitted the comments to Treasury and the Service. The comments can be viewed on the Section's website at http://www.abanet.org/tax.

DIVIDEND EXCLUSION PROVISIONS OF "JOB AND GROWTH TAX ACT OF 2003" (S.2)

Council approved comments on the dividend exclusion proposal prepared by a working group comprised of members of the Corporate Tax Committee, the Affiliated & Related Corporations Committee, the S Corporations Committee, and other committees of the Section. Herb Beller, Chair of the Section, submitted the comments to the Joint Committee on Taxation, the Senate Finance Committee, the House Ways and Means Committee, and the Treasury. The comments can be viewed on the Section's website at http://www.abanet.org/tax.

COLLECTION DUE PROCESS HEARINGS

Council approved comments regarding the criteria under which taxpayer requests for collection due process hearings under sections 6320 and 6330 should be considered "frivolous." Herb Beller, Chair of the Section, submitted the comments to the House Ways and Means Subcommittee on Oversight. The comments can be viewed on the Section's website at http://www.abanet.org/tax.

PROPOSED REPEAL OF THE FOREIGN EARNED INCOME EXCLUSION (S.1054)

Council approved comments advocating the removal of a proposed provision to repeal the longstanding foreign earned income and housing expense exclusions under section 911(section 350 of S.1054), from the Senate-passed Jobs and Growth Tax Relief Reconciliation Act of 2003. Herb Beller, Chair of the Section, submitted the comments to the Senate Finance Committee. The comments can be viewed on the Section's website at http://www.abanet.org/tax. ■

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