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SECTION OF TAXATION

The background of the cover is a blue-tinted photograph of the U.S. Capitol building in Washington, D.C., viewed through the branches of a large tree. In the foreground, a faint, semi-transparent image of the Lincoln Memorial is visible.

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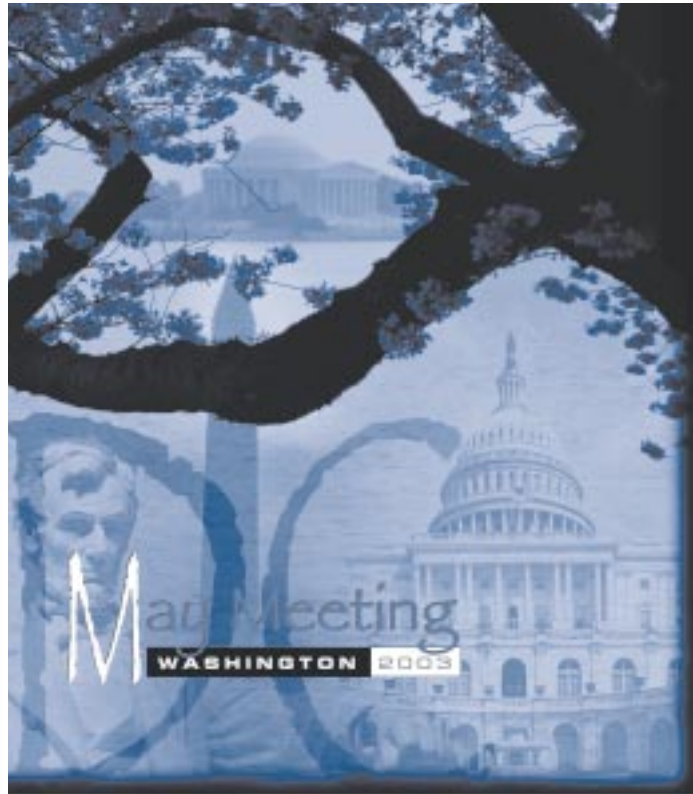
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FROM THE EDITOR

by Alice G. Abreu, Philadelphia, PA

The calendar may say it is the dead of winter, but there is nothing dead about the Tax Section at this time of year. Indeed, as this issue reflects, the Section is alive with projects and new initiatives, and much of its efforts have been devoted to the seasonally appropriate subject of shelter.

In his column, our Chair, Herb Beller, not only reflects on the ways in which technology has changed our lives and our practices (not always for the better), but goes on to provide an excellent compendium of all that has happened on the subject of tax motivated transactions (shelters) recently. Herb's column presents a comprehensive and substantive review of the issues, the government's reactions, and the Section's contribution, and is required reading for anyone who wants to know the current state of the law in this area and the possible shape of the law to come.

For Bob Dylan fans, the Special Report submitted by Associate Editor Don Bly, who made his debut as a contributor to the *NewsQuarterly* with a Point to Remember in the Fall issue, is a special treat. The report complements Herb's column by providing a concise and extremely useful synopsis of the recent amendments to the tax shelter regulations and doing it with allusions to the words and music of Bob Dylan. The Report will be enlightening both to those who have followed that field from afar and to those who spend time toiling in that vineyard.

The Points to Remember in this issue also benefit from the additions to the Editorial Board. The first Point marks the debut of Eric Mikkelsen, who explains the wrinkles involved in obtaining capital gain treatment on the sale of computer software, partic-

ularly when the sale is effected by a company that developed the software internally. His Point reflects current business structures, and even discusses the consequences of effecting such sales through single member LLCs which are treated as disregarded entities for federal tax purposes.

Next, Alex Drapatsky looks at the section 469 rules through the lens of the investor who is attracted to real estate as an antidote to reverses suffered in the stock market. Alex not only provides a primer on the operation of those rules for the novice investor, but also describes a recent Field Service Advice, a Tax Court case, and proposed regulations that show that this area of the law is far from death or irrelevance.

Finally, Kathleen Stephenson and Ed Kessel adroitly use a recently issued private letter ruling to remind us of the planning necessary to ensure that powers given to a trustee are not attributed to the donor, thereby causing inclusion of the trust's assets in the donor's estate. Their Point is a useful reminder for experienced practitioners and novices alike.

I confess that I've run out of ways to describe the job that Jack Cummings and Alan Swirski do in selecting an interesting and accomplished tax lawyer to interview for each issue and devising questions that go right to the heart of what makes the individual interesting. The job they've done for this issue is, as usual, exemplary. Their choice of Rob Hanson, who recently served as Tax Legislative Counsel in Treasury's Office of Tax Policy and previously served as Tax Counsel to the Senate Finance Committee, is particularly apt as the prospect of significant tax legislation again looms real. The interview pro-

vides a unique glimpse into the legislative process from someone who served at Treasury during both the Clinton and Bush (W.) administrations. It is a treat to read an insider's analysis of the differences between the two administrations as well as between the policy-making institutions at the two ends of Constitution Avenue.

I am also running out of superlatives for the quality of our Point/Counterpoint debates. This issue features a lively debate on Treasury's issuance of proposed regulations that have the effect of allowing current expensing of some items that last beyond the taxable year. Cal Johnson is his usual fiery self in expressing the view that Treasury's plan is seriously misguided (though Cal uses significantly stronger language), while Ken Kempson, Ellen McElroy, and Glenn Walberg retort with equal vigor that administrability is a legitimate tax policy objective that can trump theoretical purity. Can they both be right?

To wrap things up, this issue's Spotlight on the Standards of Tax Practice Committee leaves the world of substantive tax law and gives us a glimpse into the workings of a Committee that is important to every member of the Section. Focusing on it is especially appropriate in this issue, since the tax motivated transactions which both Herb's column and Don's Special Report address raise serious ethical issues. The Committee's programs are invariably informative and thought provoking; I hope you attend one at the next Section meeting. ■

FROM THE CHAIR

by Herbert N. Beller, Washington, DC



HERBERT N. BELLER

The passage of another year has caused me to reflect a bit about the changing scene of being a tax lawyer. My thoughts have focused, in particular, on (i) the tremendous impact that new technologies are having on the way we practice; and (ii) the expanding spectrum of professional and ethical issues that confront tax practitioners who advise clients with respect to tax-driven transactions or arrangements.

NEW TOOLS OF THE TRADE

More than a few of us are old enough to remember the days of 6-ply carbon paper, white-out, doing research in the library, and transmitting important legal documents primarily via U.S. mail. The day-to-day mechanics of practicing law are now quite different. With just a few keystrokes and mouse clicks we can access just about every source of primary and secondary legal authority imaginable; we can surf the worldwide web to find information and data on virtually any subject; we can instantaneously send documents all over the world; and we can carry on 24/7 electronic communication from our offices, our homes and while

traveling, with clients, colleagues, government agencies, opposing counsel and the courts.

For all lawyers, these amazing technological advances have certainly quickened the pace and intensity of our practices. For tax lawyers in particular, the computer age has enabled us to tap into the massive body of publicly available letter rulings, other private taxpayer guidance and internal IRS position papers. It also has helped us in our never-ending efforts to keep up with frequent and often major changes to the Internal Revenue Code; with the constant outpouring of Treasury regulations and other administrative pronouncements; and with the extensive tax press coverage of developments in virtually every nook and cranny of the tax world.

The Section has also benefited greatly from the new technology. I remember not too long ago when “ABAnet” first came on the scene, and a small number of Section leaders (among them, Hugh Calkins and Steve Salch) began to tout it as the wave of the future. There were, at the time, many doubters and naysayers. How wrong we were! The between-meetings work of Section management, committees and task forces is now conducted predominantly via e-mail. Our government submissions can be reviewed and quickly approved by Section leadership (including the full Council when necessary), and then instantly transmitted to multiple recipients at IRS, Treasury and other government offices. Our numerous “chat rooms” provide members with an easy way to discuss with practitioners throughout the country novel issues arising in their practices, and to keep abreast of the latest developments in specific substantive areas. *Comm-Online*, our joint undertaking with Lexis-Nexis, provides a searchable database of Section meeting program materials; and our website provides

continuous updates on Section activities, as well as links to several useful tax-related sites.

Most of us, I suspect, view these marvelous new toys as important vehicles for enhancing the quality of our professional lives. But I’m beginning to wonder whether the time may be fast approaching where we find ourselves with “too much of a good thing.” In that regard, the distinct “Big Brother” aura of our desktops, laptops, Blackberries and cellphones is becoming very difficult to escape. The daily barrage of voicemails and e-mails continues to grow. Many of these faceless messages pose difficult legal questions and include multiple and often lengthy attachments that clients expect us to review and react to immediately. We need to be very careful about allowing this frenetic pace to swallow us whole and possibly compromise the depth of our analysis. The horrendous complexities of the tax laws rarely lend themselves to fire-drill-type responses. In short, we need to save some time to smell the coffee!

ADVISING ON TAX-DRIVEN TRANSACTIONS

Complexity, in my view, has also been the main impetus for the proliferation of heavily marketed “tax products” over the past several years. As we all know, the technical requirements of most Internal Revenue Code provisions and their underlying regulations—many of which contain layers of conditions, limitations and exceptions—present considerable opportunity for intellectual gamesmanship that can yield surprising and often “too good to be true” results. Much of this stuff is like pornography: you know it when you see it; and you also know that there’s simply no plausible basis for concluding that the asserted tax treatment is consistent with the intent or spirit of the rel-

evant Code provisions. In those cases, there should be no doubt about our professional responsibility to “just say no!”

Not infrequently, however, the proper tax consequences of a tax-driven transaction or arrangement honestly can be viewed as falling somewhere in the gray zone. A number of recent taxpayer victories in the courts bear witness to the fact that presumably reasonable minds can and do differ on whether or how to apply the business purpose, economic substance and similar over-arching doctrines of the tax law. In those situations, beyond giving our clients a totally candid assessment of their chances of success, we need to advise them regarding their return disclosure obligations and their exposure to potential penalties. The legal framework for dispensing that advice is changing dramatically as a result of recent regulations and proposed legislation designed to curb abusive tax shelters. Some of these measures impose new responsibilities and potential sanctions upon practitioners who advise on tax-driven transactions, and could have a much broader reach than might first meet the eye.

Disclosure/Penalty Rules. The new ground rules relating to tax shelter disclosure and penalties are still evolving. Recently proposed taxpayer disclosure regulations under section 6011 substantially revise and broaden the existing “reportable transaction” triggers along the lines outlined by Treasury last spring. Among the new triggers are (i) section 165 loss transactions exceeding specified dollar thresholds; (ii) transactions that involve public companies (or certain other large business taxpayers) and generate book-tax differences exceeding specified dollar thresholds; and (iii) “brief asset holding period” transactions that give rise to substantial tax credits. Importantly, these rules now apply to corporate and noncorporate taxpayers, and they extend as well to estate and gift, employment and excise taxes. Although still subject to comment and change, the revised disclosure rules became effective Janu-

ary 1, 2003. The preliminary reaction of some practitioners is that they are technically ambiguous in a number of respects, may be too broad in their reach, and could result in a deluge of paperwork that IRS is unable to effectively process.

The new regulations do contain several targeted exceptions to disclosure (principally under the book-tax rules). However, in contrast to prior versions, broad exceptions are no longer provided for transactions that can be shown to reflect “customary commercial practice” or a “long-standing/generally accepted understanding” that the asserted tax benefits are permitted, or for which “no reasonable basis for IRS denial”

may exist. The Section’s Tax Shelter Task Force is preparing comments on the proposed regulations, including suggestions for a so-called “angel list” of additional specific disclosure exceptions that Treasury has indicated might be included in the final regulations.

In the penalty arena, bills introduced last year in both the House and the Senate are tied directly to the regulatory “reportable transaction” concept and would, among other measures, (i) impose substantial strict liability nondisclosure penalties for both listed and non-listed transactions; (ii) significantly increase the existing 20% accuracy-related penalty under section 6662; and (iii) elimi-



nate the section 6664(c) “good faith”/“reasonable cause” safety valve for avoiding penalty. As reported in my fall column, the Section has submitted extensive comments with respect to these proposals. When and if Congress eventually acts in this area (as it probably will), the stakes of failing to comply with the reportable transaction disclosure rules will increase greatly.

Tax Advisers as Watchdogs. It’s a new ballgame as well for practitioners who give advice in connection with reportable transactions. In this regard, Treasury also recently proposed revised and more stringent “list maintenance” regulations under section 6112. These generally require that “organizers” and “sellers” of “potentially abusive tax shelters”—including “material advisors” who know or have reason to know that the transaction is a “reportable transaction”—maintain (for 10 years) certain information that must be furnished to IRS within 20 days after its request. Subject to valid assertions of “privilege” (which IRS may well challenge), the required information includes the identities of any person advised (even if not known to be an ultimate participant in the transaction), any tax opinions or analyses, and a detailed description of the transactional structure and intended tax consequences. A “material advisor” is anyone who makes an oral or written statement to any person regarding the potential tax consequences of the transaction and receives a fee of at least \$250,000 for corporate transactions or \$50,000 for noncorporate transactions.

These rules cast a wide net. They apply even to tax advisers who receive (or whose firm receives) nothing more than a reasonable hourly rate for their services (*i.e.*, no entrepreneurial stake in the transaction); they appear to apply even if a tax lawyer doesn’t deal directly with the client (*i.e.*, merely consults with a firm colleague); and firm-wide fees received for both tax and non-tax services in connection with the trans-

action are counted toward the minimum fee threshold.

As with the disclosure rules, the bite of the listing regulations would be considerably more painful from a penalty standpoint if proposed legislation raising the ante under sections 6707 and 6708 is enacted. What’s more, the Senate version of the proposed legislation would essentially accelerate the listing rules by requiring that each material advisor with respect to a reportable transaction file with IRS, *immediately after furnishing the advice*, an information return that describes the transaction and the advice provided (“including any potential tax benefits represented to result from the transaction”).

Needless to say, the listing rules and any ultimately enacted material advisor disclosure requirements could cause serious tensions between tax practitioners and their clients. For example, what if the practitioner thinks a reportable transaction exists but the client disagrees, and this issue doesn’t surface until after the services are performed? Can the practitioner avoid any list maintenance or reporting obligation by withdrawing from the representation and returning any fees paid? These and other difficult questions raised by the new listing regulations are being considered by our Tax Shelter Task Force and will be addressed in forthcoming comments.

The Section is also following two other “watchdog”-type measures which are primarily of interest to non-tax lawyers, but potentially could affect tax lawyers as well. One involves the “up the chain” reporting obligations imposed under the recent Sarbanes-Oxley corporate responsibility legislation on any lawyer who in the course of “appearing and practicing before the [SEC]...becomes aware of evidence of a material [securities law] violation.” The other involves the so-called “Gatekeeper Initiative,” a cooperative effort by numerous countries throughout the world to combat criminal money laundering activity. Evolving propos-

als would require lawyers who serve as “financial intermediaries”—*i.e.*, who receive or transfer funds on behalf of clients—to file “suspicious activity reports” and comply with other measures that might breach the confidentiality and other traditional protections of the attorney-client relationship. The Section has concerns about whether or when tax lawyers might be considered to be practicing before the SEC for purposes of the new attorney conduct standards under Sarbanes-Oxley, or engaging in “financial intermediary” activities in the course of representing transactional clients for purposes of the Gatekeeper Initiative. We have provided input to the special ABA task forces charged with primary responsibility for these areas, and will continue to monitor them closely.

Tax Opinions. An important piece of unfinished business with respect to the Government’s multi-front attack on abusive tax transactions relates to Circular 230 standards for rendering opinions on tax shelter transactions. Most of the modern day tax shelters—at least those marketed to large corporations—have been supported by favorable tax opinions from outside firms. The concern is that many of these opinions may be based on unreasonable factual assumptions (most notably, with respect to the business purpose for the transaction) and less than full consideration of the various legal theories that the IRS might plausibly assert in challenging the transaction (especially nonstatutory doctrines). Substantially revised Circular 230 regulations on this subject are expected to be re-proposed soon. They will impose heightened factual and legal diligence requirements for such opinions, the violation of which could subject practitioners to suspension or other serious professional sanction (including censure and monetary penalty under the proposed tax shelter legislation). Given these high stakes, it is crucial that the circumstances in which the new diligence

requirements apply be defined as precisely as possible. This is a very difficult exercise.

The Section has recommended six alternative “trigger” categories: (i) “listed” transactions; (ii) transactions having a “principal” (not “significant”) purpose of tax avoidance; (iii) transactions involving conditions of confidentiality; (iv) transactions providing contractual protection against loss of the asserted tax benefits; (v) opinions used by a third party in marketing the transaction to taxpayers; and (vi) opinions for which the practitioner has received a fee which exceeds a specified dollar threshold and is not reasonably related to what would have been received based on a reasonable hourly rate. We also have proposed an exception for transactions which, even though obviously tax-driven, are “clearly consistent” with the underlying purpose of the relevant Code provisions (*e.g.*, section 41 low income housing credit deals).

Clients who desire the comfort of a tax opinion for transactions involving any of our suggested trigger circumstances can reasonably be expected to bear the added cost that full-blown opinions typically entail. It’s important to note, however, that the usual “penalty protection” purpose of obtaining a Circular 230-compliant tax opinion may not be achievable under the proposed tax shelter legislation if the practitioner is a “material advisor” by reason of the level of fees received—or even if not a material advisor, by reason of the contingent nature or source of any compensation. The proposed legislation would also preclude reliance on any opinion that did not meet factual and legal diligence requirements that essentially mirror those contained in Circular 230.

In the meantime, under yet another set of Treasury regulations proposed on the last day of 2002, with an effective date of January 1, 2003, an opinion with respect to a “reportable

transaction” (per the new disclosure regime) will not be usable for purposes of invoking the “reasonable cause/good faith” exception of section 6664(c) if the transaction was not properly disclosed. Moreover, a recent D.C. federal district court decision (*KPMG*, 12/20/02) would appear to threaten availability of the attorney-client privilege for return-related tax opinions or advice in connection with both shelter and non-shelter transactions.

Another aspect of the Circular 230 tax shelter rules that bears watching is the so-called “derivative responsibility” requirement. It would impose Circular 230 obligations and sanctions for violations by firm members upon tax practitioners who occupy managerial or supervisory positions in the firm. There has been no guidance to date as to who short of a tax department head might be at risk, or what types of internal firm procedures might suffice to avoid problems under this potentially far-reaching provision. The implications for large, multi-office firms are especially uncertain and exacerbated by the proposed tax shelter legislation, which would expand the authorized Circular 230 sanctions to include monetary penalties imposed on the practitioner’s firm if it “knew or reasonably should have known” of the sanctioned conduct.

Sarbanes-Oxley. The “auditor independence” provisions of the Sarbanes-Oxley Act prohibit public accounting firms from furnishing “legal services” or “expert services” to audit clients, and permit “tax services” to such clients only if pre-approved by the audit committee of the client’s board of directors.

In early December, the SEC issued proposed rules which would implement the new auditor independence requirements. The accompanying commentary cites “the formulation of tax strategies (*e.g.*, tax shelters) designed to minimize a company’s tax obligations” as an

“example” of “types of tax services” that “may” cause an auditor to lack independence—because the provision of such services could “require the accountant to audit his or her own work, to become an advocate for the client’s position on novel tax issues, or to assume a management function.” Comprehensive comments on the “tax services” aspects of the proposed rules were prepared by the Section’s Sarbanes-Oxley Task Force and recently submitted to the SEC. The comments are available on the Section website at www.abanet.org/tax/pubpolicy/2003. I commend them to your attention.

THE CHALLENGES AHEAD

The dynamics and challenges of being a tax lawyer are indeed changing and will no doubt continue to change. The new technologies will certainly aid us in meeting these challenges by increasing our efficiency and productivity; but they are not a substitute for good hard thinking and careful analysis.

As for tax shelters, they will, of course, never disappear entirely. However, the many pieces of the anti-tax shelter administrative and legislative jigsaw puzzle are finally starting to come together and are beginning to put a real damper on temptations to promote and engage in tax-abusive behavior. Practitioners will be expected, indeed obligated, to play a more significant role in this important battle to preserve the integrity of our tax system. Our biggest challenge will be to perform that role effectively, but without impairing one iota our ability or desire to represent clients zealously and diligently within the bounds of the law.

I hope that the coming year brings much personal and professional satisfaction to each of you and your families. ■

COUNCIL ACTIONS

By N. Susan Stone, Secretary, Houston, Texas

The Council of the ABA Section of Taxation met on October 17, 2002, during the Fall Meeting of the Section at the St. Regis Hotel in Los Angeles. The Council heard reports and took action on the following items.

SECTION LEADERSHIP APPOINTMENTS

Herb Beller, Chair of the Section, announced the following Section appointments: Linda P. Holman and Steven C. Salch will co-chair the new Business Activity Nexus Task Force. Joel D. Zychick will serve as Council Director for the Task Force. The Task Force will focus on developing a workable nexus standard to be applied to domestic and international e-commerce transactions. Herb further announced that the Sarbanes-Oxley Task Force had been constituted and that Stuart J. Offer will be its chair.

VITA TRAINING (VOLUNTEER INCOME TAX ASSISTANCE)

Dick Lipton, Immediate Past Chair of the Section, reported that two alternative VITA training sessions would be offered to Section Officers, Council and members at the San Antonio Mid-Year meeting. The sessions will tutor Section members on how to provide uncompensated tax return preparation assistance to low-income taxpayers. The training, which forms part of the Section's pro-bono out-

reach plan, is mandatory for Section Officers and Council, and highly recommended for Section members.

ATPI TRUSTEES

Herb Beller reported that the Tax Section would have the opportunity to fill two of the trustee positions on the Board of Trustees of the American Tax Policy Institute. Herb appointed Paul J. Sax, former Chair of the Section, to fill one of the positions and stated that Council must fill the other position. Council unanimously elected William J. Wilkins, Vice-Chair (Government Relations), to fill the other ATPI trustee position.

JOINT TASK FORCE ON TRANSFER TAX

Council Director Lloyd Leva Plaine recommended that the Tax Section participate with other organizations, namely the Real Property Probate and Trust Law Section, the American Bankers Association, the American College of Tax Counsel, the American College of Trust and Estate Counsel and the AICPA, in preparing a report on the administrability of the gift, estate and generation-skipping transfer tax laws, as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001. Council unanimously approved the recommendation and thereafter requested that the ABA Board of

Governors approve the Section's participation in this group.

DUES WAIVER FOR LONG-TIME SECTION MEMBERS

Stanley Blend, Vice-Chair (Committee Operations), reported that the Section had received a letter requesting the Section to waive the payment of dues by persons who had been members of the Section for at least 50 years. Noting that such a waiver would be consistent with the dues waiver policy of the ABA, Council unanimously approved the recommendation.

TAX SECTION FUNDING FOR ATPI

After reviewing the activities of ATPI over the past year and its contemplated future projects and needs, the Council unanimously voted to continue the Section's support of ATPI with a significant contribution that is subject to approval by the ABA Board of Governors.

SECTION FUNDING FOR TELECONFERENCES

Karen Hawkins, Vice-Chair (Professional Services), recommended that the Section include a \$30,000 line item in future annual budgets to cover the expense of two free member teleconferences per year. After discussion, Council approved the recommendation. ■

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QUESTIONS? Contact the Section's Technology Specialist at taxweb@staff.abanet.org.

SPECIAL REPORT:

CHAPTER 61 REVISITED: THE LATEST ROUND OF PROPOSED AND TEMPORARY TAX SHELTER REGULATIONS

by Donald R. Bly, Atlanta, GA

***He found a promoter who nearly fell off the floor
He said, "I never engaged in this kind of thing before,
But yes I think it can be very easily done..."***

— Bob Dylan, *Highway 61 Revisited*

The times they are a-changin'. For the fourth time since promulgating them in February 2000, the Service has amended and restated the triumvirate of provisions—Treas. Reg. sections 1.6011-4T, 301.6111-2T, and 301.6112-1T—commonly referred to as the “tax shelter regulations.” Although the regulations could possibly be revised again before this report is in print, following is a summary of the significant changes and questions generated by these amendments.

BACKGROUND

The first version of the tax shelter regulations had essentially one target in its collective sight: confidential corporate tax shelters. After a decade of hibernation, section 6111, which previously addressed only 1980s-era style tax shelters, was amended in 1997 to require the registration of certain “confidential arrangements.” These arrangements are, in general, transactions structured to avoid or to evade corporate tax and offered under conditions of confidentiality. When temporary and proposed regulations were published under this section in February 2000, the package included two companion regulations that were intended primarily to backstop section 6111. Treas. Reg. section 1.6011-4T

was promulgated under Treasury’s section 6011(a) power, which grants Treasury the authority to require certain statement filings, and required corporate taxpayers to disclose their participation in reportable transactions (generally, listed transactions and other confidential or marketed tax shelters). Section 6112 was similarly dusted off, and Treas. Reg. section 301.6112-1T was amended to require certain promoters of corporate tax shelters to maintain lists of their investors.

By June 2002, however, Treasury knew that the tax shelter regulations’ net had not snared the number of transactions and taxpayers Treasury had hoped and it attributed this shortfall to two causes. One of these was, in the opinion of Treasury, the “overly narrow manner” in which taxpayers were interpreting the disclosure and registration requirements. This problem has been addressed in both the June 2002 and the most recent amendments through a broadening of the concept of “substantially similar transactions.”

The second and more significant of these failings was that many (if not most, at least in number) of the targeted tax shelters were not entered into by corporations, but rather by individuals and partnerships. This problem was addressed temporarily in the June 2002 amendments to Treas. Reg. section 1.6011-4T, in which Treasury required certain noncorporate taxpayers to disclose their involvement in listed transactions, and promised further extensions of this regulation to these noncorporate taxpayers. In October 2002, something was delivered.

In these October 2002 amendments, Treasury explicitly has moved the spine of the tax shelter regulations

from Treas. Reg. section 301.6111-2T to Treas. Reg. section 1.6011-4T. Section 6111(d), the initial impetus for the tax shelter regulations, has become Treasury’s greatest limitation, because it is the only one of the three relevant Code provisions which is limited on its face to corporate transactions. (Section 6011(a) is, of course, an extremely broad grant of administrative power, and section 6112(b)(2) permits Treasury to apply the list maintenance requirement to arrangements having potential for tax avoidance or evasion beyond section 6111 tax shelters.) The latest package of amendments performs the following functions:

- Completely overhauls and simplifies the disclosure requirements, which now apply to all taxpayers that participate in any one of six types of reportable transactions;
- Simplifies the list maintenance requirements, which now apply to essentially any party that receives a fee in connection with a reportable or registered transaction; and
- Makes only conforming changes to the section 6111 regulations, announcing instead that Treasury will await the enactment of legislation requiring the registration of section 6011 reportable transactions before making substantive changes. Thus, Treasury makes clear that the concepts and principles set forth in the latest version of Treas. Reg. section 1.6011-4T’s disclosure provisions will serve as the exclusive mechanism for the registration and list maintenance requirements in the very near future. The specifics of this mechanism are discussed below.

TREAS. REG. § 1.6011-4T: THE DISCLOSURE REQUIREMENT

Treas. Reg. section 1.6011-4T requires every taxpayer that has directly or indirectly participated in a “reportable transaction” to attach a disclosure statement on Form 8886 (not yet available at press time) to its return for the relevant taxable years. Treas. Reg. section 1.6011-4T(e) provides that the relevant taxable years are each taxable year for which the taxpayer’s federal income tax liability is affected by its participation in the transaction. Furthermore, if a transaction was not a reportable transaction when entered into, but subsequently becomes a reportable transaction (e.g., it is added to the “list”), the disclosure statement must be filed with the next return filed after the transaction becomes reportable. Protective disclosures are, not surprisingly, permitted. And for those seeking shelter from the storm, the regulations provide that taxpayers may request a ruling on whether disclosure is required. Ironically, such request must disclose all relevant facts relating to the transaction.

REPORTABLE TRANSACTIONS

There are six categories of transactions which qualify as reportable transactions. Replaced is the conjunctive test which used to govern this regulation (the “two of five” plus projected tax effect test); if any one of these six tests is met, regardless of how “un-shelter-like” the transaction may be, disclosure is required.

Listed Transactions. A listed transaction is any transaction that is the same or substantially similar to a transaction that the Service has identified in published guidance as a listed transaction. This is not a change; listed transactions have been a category of reportable transactions since the regulations were first promulgated. While one may imagine finding “the list” engraved on granite tablets and sitting on the Secretary’s desk, the list can most easily be assembled by combin-

ing Notices 2002-21, 35, 50 and 65 and Rev. Rul. 2003-6.

Confidential Transactions. A confidential transaction is simply a transaction that is offered under conditions of confidentiality. Whether a transaction is offered under these conditions depends on all relevant facts and circumstances, including any oral agreements or implied understandings, and regardless of whether any such agreement or understanding is legally binding. The taxpayer’s privilege to maintain the confidentiality of a communication, such as communications with an attorney, is not a condition of confidentiality. Significantly, the regulation contains a safe harbor: A transaction is treated as presumptively not offered under conditions of confidentiality if every person who provides a statement as to the potential tax consequences of the transaction provides express written authorization to the taxpayer that it may disclose to any person the structure and tax aspects of the transaction, as well as all materials—including opinions—that are provided to the taxpayer.

This presumption has been changed in two interesting ways from the prior version of the regulation. First, the regulations had previously contained simply a cross-reference to Treas. Reg. section 301.6111-2T(c), which also defines conditions of confidentiality. That section also has a presumption, but because that regulation deals with section 6111 tax shelters, it requires only that the “tax shelter promoter” provide written authorization to disclose to its “offerees.” The new Treas. Reg. section 1.6011-4T presumption requires that all persons who give advice with regard to the transaction must provide such written authorization to the taxpayer. Thus, if Attorney A advises Promoter P with regard to a transaction into which Taxpayer T enters, it seems that now both P and A must provide authorization to disclose to T. Secondly, the presumption now only applies if the written authorization to disclose is effective from the “commencement of discussions,” a powerfully vague point in time.

Transactions with Contractual Protection. These transactions are those for which the taxpayer has obtained or has been provided with contractual protection against the possibility that part or all of the intended tax consequences of the transaction will not be sustained. These protections include rescission rights, rights to refunds of fees, fees contingent on the realization of tax benefits, insurance protection, or an indemnity (other than “customary indemnities”). This category is found in essentially the same form in prior versions of Treas. Reg. section 1.6011-4T.

Loss Transactions. The loss transaction category represents the most significant change to Treas. Reg. section 1.6011-4T. A loss transaction is one that results in, or is reasonably expected to result in, a taxpayer claiming a loss (under section 165) of at least:

- \$10 million in any single taxable year or \$20 million in any combination of taxable years for corporations;
- \$5 million in any single taxable year or \$10 million in any combination of taxable years for partnerships or S corporations, whether or not any losses flow through to one or more partners or shareholders;
- \$2 million in any single taxable year or \$4 million in any combination of taxable years for individuals or trusts, whether or not any losses flow through to one or more beneficiaries; or
- \$50,000 in any single taxable year for individuals or trusts if the loss arises with respect to a section 988 foreign currency transaction.

For purposes of determining its section 165 loss, a taxpayer cannot take into account offsetting gains, or other income or limitations. A section 165 loss for these purposes also includes any amount deductible by virtue of a provision that treats a transaction as a sale or disposition (e.g., section 741). Two fairly narrow exceptions are provided from the definition of loss transaction. Notably missing from this list is an exception

for taxpayers who merely sell an asset for a loss in excess of the thresholds listed above. However, Treasury states in the preamble that it is considering adding an exception for losses resulting from the sale of securities on an established securities market, if the basis used to compute the loss is equal to the “cash paid by the taxpayer” for the securities.

Transactions with a Significant Book-Tax Difference. This category casts a large net in a small pond. It applies only to (1) 1934 Act reporting companies and their related companies and (2) business entities that have \$100 million or more in assets (aggregating the assets of all related business entities). The transactions covered are those where the treatment of any item or items from the transaction for federal income tax purposes differs, or is reasonably expected to differ, by more than \$10 million from the treatment of the item for book purposes in any taxable year. Special rules are provided for consolidated returns, foreign taxpayers, disregard-

ed entities, partners, and shareholders of certain foreign corporations.

The breadth of this category can be measured by the “angel list” of exceptions provided by Treas. Reg. section 1.6011-4T(b)(6)(iii). This list describes certain items which, presumably, Treasury believes fall within the definition of an item with a book-tax difference, but which will not be required to be disclosed. These items include cancellation of indebtedness income; federal, state, local and foreign taxes; compensation of employees; charitable contributions; and tax exempt interest—in other words, your classic tax shelters. Irony aside, it seems clear that the sweep of this category will cause affected taxpayers to get tangled up in blue regarding the potential disclosure requirement that will attach to some basic transactions (e.g., sections 351 and 721 transfers). In meetings since the promulgation of these regulations, however, Treasury officials have indicated that the angel list may be expanded by as many as 50 new transactions.

Transactions Involving a Brief Asset Holding Period. This is a new and narrow category. This provision will require the disclosure of any transaction resulting in a tax credit (including any foreign tax credit) exceeding \$250,000 if the underlying asset giving rise to the tax credit is held by the taxpayer for less than 45 days. The target of this category is presumably transactions similar to those in *Compaq Computer Corporation v. Commissioner*, 277 F.3d 778 (5th Cir. 2001), and *IES Industries v. U.S.* 253 F.3d 350 (8th Cir. 2001), two notable government losses in recent years.

EFFECTIVE DATES

The new version of the regulations will apply to transactions entered into on or after January 1, 2003. Transactions entered into before this date will continue to be subject to the version of Treas. Reg. section 1.6011-4T in effect as of the date the transaction was entered into. ■

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POINTS TO REMEMBER

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CAPITAL GAIN FROM SELLING COMPUTER SOFTWARE: A FEW BUGS

by Eric Mikkelson,
Kansas City, MO

In today's economy, owners of many technology and internet-related companies have been forced either to liquidate the company's assets or to face bankruptcy. Regardless of whether a sale is due to economic hardship or to other reasons, the selling company's most valuable asset may be computer software developed internally, but not held for sale to customers in the ordinary course of business. While the character of income or gain recognized upon such an asset sale is fairly well-defined in the case of an individual developer (section 1235 often allows capital gain treatment) and in the case of a large corporate developer (sections 1221 and 1231 often allow capital gain treatment), the character of income or gain recognized in certain other situations is unclear.

These difficult situations include sales by single-member LLCs and S corporations, where such entities are owned by an individual active in the entity's creation of the software. The tax issues raised by such sales are

complicated by the dual nature of computer software under intellectual property laws, which often allow both copyright and patent protection for a new computer software program.

CAPITAL GAIN UNDER SECTIONS 1235 AND 1221

Because certain newly-developed computer software can be either copyrighted or patented (or both), either of two provisions can govern the character of income or gain recognized on the sale: section 1235 and section 1221. If an individual actually develops and then sells patentable software, section 1235 (applicable to patents and patentable property) may provide capital gain treatment. But section 1235 only applies to individual holders of such property and not to partnerships, limited liability companies or corporations. In certain cases, an active individual partner/inventor may be considered a holder of computer software partnership property under section 1235, along with other individual partners who were not active in the creation of the software. *See* Treas. Reg. § 1.1235-2(d)(2). However, there is no apparent equivalence for S corporation shareholders.

If section 1235 is unavailable, an asset may nonetheless qualify as a capital asset under section 1221, which defines a capital asset by what it is not. Computer software can fall within the section 1221(a)(3) exclusion from the definition of capital asset, which applies to certain copyrights or copyrightable material. *See* Treas. Reg. § 1.1221-1(c)(1); *Levy v. Commissioner*, T.C. Memo 1992-471. Section 1221(a)(3)(A) provides that a copyright is not a capital asset when held by a "taxpayer whose personal efforts created such property." While one can find authority for the proposition that an entity (e.g., a corporation) cannot have "personal efforts" which would lead to the conclusion that this exclusion does not apply where the taxpayer is an entity, much of the pub-

lished rationale for such a proposition disappears if a flow-through entity's individual owner has been active in developing the software. *See* Rev. Rul. 55-706, 1955-2 C.B. 300, *superseded in part by* Rev. Rul. 62-141, 1962-2 C.B. 182.

INDIVIDUALS AND SINGLE-MEMBER LLCS

An individual owner of a single-member LLC would presumably have the benefit of section 1235 for patentable software he or she created in the LLC if the LLC is a disregarded entity for federal income tax purposes, as it would be unless it has filed an election to be taxed as a corporation. But where an individual (or a disregarded single-member LLC) employs a non-owner to create the software, some or all of the section 1235 benefit may be lost, unless the owner, notwithstanding the employee's contribution, exerts efforts sufficient to assume the status of joint inventor. *See* IRC § 1235(b)(2)(A); Treas. Reg. § 1.1235-2(d).

If the owner's "efforts" (as defined by the section 1235 regulations) are insufficient, section 1221(a)(3)(A) may then be implicated to prevent capital gain treatment because the regulations' definition of "personal efforts" includes mere direction and guidance provided to the employees in creating the software and copyrights held by individuals whose personal efforts created the copyright are not capital assets. *See* Treas. Reg. § 1.1221-1(c)(3). The result may be that capital gain treatment is available both to an individual who works closely enough with an employee in developing the software to be considered a joint inventor (under section 1235) and also to an individual who does not participate at all in the development process (no personal efforts under section 1221). Nevertheless, an individual employer who falls between these two ends of the spectrum may not receive capital gain treatment.

S CORPORATIONS

Another interesting question arises in the case of a single, active owner of an S corporation whose efforts, perhaps alone or even together with those of certain employees, created the software within the entity. Section 1235 probably does not apply where the software is developed and held by an S corporation, because a corporation is not a holder under section 1235. Furthermore, to the extent that the owner was instrumental in developing the software, perhaps with a view toward substantial additional monetary returns, the copyrightable software may be excluded from the definition of a capital asset under section 1221(a)(3)(A) to the extent it is deemed held by the taxpayer whose personal efforts created it.

The argument against exclusion under section 1221(a)(3)(A) is significantly more persuasive if fair market wages are paid to all employees (including the owner) during such development. *See* Rev. Rul. 55-706, *supra*; PLR 8042121 (July 25, 1980). Indeed, where all such costs and expenses are paid at the current going rate and the work is all performed by non-owner employees, there is probably little cause for concern. Accordingly, most large corporate software developers can be relatively confident that section 1221(a)(3)(A) will not apply.

The problem is that where the software is created entirely or in large part by the S corporation shareholder/employee and is then sold for a significant sum, the section 1221(a)(3)(A) issue may arise. In such a case, where the owner/employee played a significant role in the creative process, as opposed to merely exercising administrative control over the creators, the applicability (or inapplicability) of section 1221(a)(3)(A) should be clarified, especially in light of *Chronicle Publishing Co. v. Commissioner*, 97 T.C. 445 (1991). After reviewing the legislative history of section 1221(a)(3), the Tax Court in *Chronicle* concluded that for purposes of section 1221(a)(3), both the terms

“taxpayer” and “person” include corporations. Since it was focusing on a different subsection (section 1221(a)(3)(B)), it did not explicitly hold that a corporation could exert the personal efforts described in section 1221(a)(3)(A), but the implication to that effect is there.

Despite this implication, the fairly recent TAM 200119005 (Nov. 21, 2000) suggests that the Service may still view section 1221(a)(3)(A) as inapplicable to corporations, even S corporations, at least where all costs and expenses are paid for at fair market value. While this is encouraging, it stops short of resolving the issue because the facts in TAM 200119005 did not explicitly include an S corporation shareholder active in creating the asset. Furthermore, the issue in the TAM was primarily section 1221(a)(3)(B), just as in *Chronicle*.

SUMMARY

From a policy standpoint, capital gain treatment in all cases would probably encourage innovative software invention and more clearly reflect Congressional intent. The efforts required to confer the benefits of section 1235 on a single-member LLC (or sole proprietor) employing the creator of the software should be consistent with those personal efforts required to disqualify an asset from the definition of capital asset under section 1221(a)(3)(A). If this connection is made, then the owner employing the creator would either have sufficient efforts to qualify under section 1235 or, if not, could be confident that his or her efforts would not rise to a level that excludes the software from being a capital asset under section 1221(a)(3)(A).

Similarly, to the extent the owner, whether an amateur or professional inventor, could have had capital gain treatment under section 1235 if he or she had created and developed the software individually, so too should an S corporation shareholder have capital gain treatment when the S corporation develops the software using the shareholder's efforts to do so. To

include computer software under the exclusion of section 1221(a)(3)(A) may be contrary to the legislative intent of that section, which was intended to cover artistic works in a narrow sense and, in any event, predated computer software. *See* *Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189 (1998).

Given the dual nature of computer software (often copyrightable and patentable), additional guidance that clarifies the results in the foregoing situations would be welcomed. Such guidance could be provided under section 1235, section 1221, or both. In the meantime, an individual or single-member LLC may avoid some risk under section 1235(b)(2) by contracting with, rather than employing, the non-owner inventor. Similarly, where a liquidation sale of all or substantially all assets is contemplated, the S corporation owner can reduce risk by instead selling stock to ensure capital gain treatment, but this is not always possible in a buyer's market.

TRAPS FOR NOVICE REAL ESTATE INVESTORS

*by Alexander Drapatsky,
Chicago, IL*

As the stock market has tumbled and investors' savings dwindled, many have sought alternatives to the market. Some of these investors, encouraged by low interest rates, are investing in rental real estate. Although neophyte investors have undoubtedly heard of the tax benefits that accompany investments in real estate, they might be less aware of the pitfalls that await the unwary in this area.

Since the Tax Reform Act of 1986 added section 469 to curb tax shelters, the Code has treated income and expenses resulting from real estate as “passive” and thus only deductible against income from other passive activities, with certain exceptions. This passive income regime substantially reduces the tax benefits attribut-

able to real estate investments. Recent developments in this area show that the Service is assiduously enforcing the passive income regime and those who invest without an eye to the restrictions imposed by section 469 may be sorely disappointed.

PASSIVE ACTIVITY LIMITATIONS

Perhaps the largest misconception investors harbor is that they will be able to deduct all losses (the excess of deductions over income), resulting from their rental real estate investments. In fact, the Code prevents most investors from deducting losses resulting from passive activities, and investing in real estate is, for most investors, a passive activity. Section 469(c) defines a passive activity as either: (1) an activity in a trade or business in which a taxpayer does not materially participate, or (2) a rental activity, without regard to whether the taxpayer participates in such activity. An activity that is passive for tax purposes will remain so regardless of whether a taxpayer invests in such activity individually or through a separate legal entity.

Deductions resulting from passive activities can only be taken against passive income, not against other types of income such as wages or portfolio income (interest income, dividends, royalties, and some capital gains). Taxpayers can carry a passive activity loss forward indefinitely and deduct it against passive income in subsequent years. In addition, taxpayers can deduct in full any unused deductions in the year they dispose of their entire interest in the passive activity (in this case, the real estate investment).

An exception will permit a taxpayer to treat rental real estate activities as non-passive if the taxpayer is, in effect, a real estate professional who satisfies the conditions set forth in section 469(c)(7). Under section 469(c)(7), which I will refer to as establishing a “real estate professional” test, (1) a taxpayer must own at least a 10 percent interest in a rental

real estate endeavor; (2) more than half of the personal services performed by the taxpayer in all trades or businesses during the tax year must be in real estate endeavors in which the taxpayer materially participates; and (3) the taxpayer must perform more than 750 hours of services during the tax year in real property endeavors in which he or she materially participates. The Code provides numerous examples of what constitutes material participation. However, even if a taxpayer materially participates in a real estate endeavor and otherwise satisfies section 469(c)(7), the taxpayer’s ability to deduct losses from real estate endeavors will nevertheless be limited.

LIMITATIONS ON DEDUCTIONS ATTRIBUTABLE TO REAL ESTATE

The major expenses that taxpayers want to offset against rental income are interest expenses, depreciation, property taxes, and maintenance costs. Generally, the Code allows taxpayers to offset their passive rental income against the foregoing expenses if those arise in connection with the conduct of a rental activity for the taxable year, or with a rental loss carried forward from a prior taxable year. Treas. Reg. § 1.469-2T(d).

Under current law, a taxpayer who satisfies the section 469(c)(7) real estate professional test can deduct up to \$25,000 of net passive losses attributable to rental real estate against non-passive sources such as salary and other investment income. This \$25,000 maximum real estate related passive activity deduction is reduced, but not below zero, by 50 percent of the amount by which a taxpayer’s adjusted gross income for a year exceeds \$100,000; it is completely phased out when the taxpayer’s adjusted gross income (“AGI”) reaches \$150,000. Thus, when the taxpayer’s AGI exceeds \$150,000, the \$25,000 deduction is disallowed, even if the loss was incurred. This limitation applies when a taxpayer satisfies the “real estate professional” test in a personal capacity, as well as when a tax-

payer conducts business through a separate legal entity.

Some taxpayers may be affected by the alternative minimum tax (“AMT”). Depending on their other income and deductions, the AMT may require some taxpayers to recompute their real estate related deductions, which would allow a taxpayer to utilize fewer deductions in calculating taxable income.

RECENT DEVELOPMENTS

Since the Tax Reform Act of 1986, the Service has worked very hard to preclude ineligible taxpayers from utilizing passive loss deductions, particularly where a taxpayer uses separate entities to conduct real estate endeavors. For example, in FSA 200035006 (May 16, 2000), the Chief Counsel’s Office opined that the passive activity rules of section 469 apply to income, deductions, and credits from a grantor trust’s interest in a partnership at the grantor’s individual level, not at the trust’s level.

This is an important development because Temp. Treas. Reg. section 1.469-1T(b)(2) exempted grantor trusts from the passive activity rules of section 469. Nevertheless, this FSA clearly states that even if a grantor trust itself is exempt from the passive activity rules, pursuant to section 671, the grantor must report all of the income of a grantor trust on his or her income tax return. A grantor who is required to report income items from a grantor trust would be subject to passive loss limitations. Thus, this guidance precludes what some thought was an entity-level loophole by precluding taxpayers from using grantor trusts to accomplish that which is not possible at the individual level. Although an FSA is technically not precedent because it is not binding upon the Service’s auditors or during the Service’s appeals process, it is nevertheless important because it indicates the Service’s views on this matter.

Additionally, Treasury recently issued final regulations that will affect the tax treatment of some deductions attributable to passive activities. In the past, some taxpayers had attempted to

circumvent the passive loss limitations by lending money to an entity through which they conducted their rental activities and then claiming that the entity's interest expenses should constitute a non-passive expense. In August of 2002, Treasury issued final regulations addressing "self-charged income".

According to these regulations, the portion of non-passive interest income allocable to passive interest expenses should be recharacterized as passive income, thereby allowing such taxpayers possibly to reduce their total taxable income. Treas. Reg. § 1.469-7. This new regulation also applies to loans made among "brother-sister" legal entities. *Id.*

Although this recently issued "self-charged income" regulation will allow some taxpayers to have more passive income against which they can net some real estate related expenses, courts have generally limited this regulation to interest income. For example, the Service recently prevailed in a fourth circuit case that held that Treas. Reg. section 1.469-7 (which at the time of this case was a proposed regulation) did not apply to management fee income. *Hillman v. Commissioner*, 263 F.3d 338 (4th Cir. 2001). In this case, the court held that a taxpayer who actively managed property through an S corporation could not net his passive real estate related losses from various entities in which he owned interests against his S corporation management income. *Id.* The court held that Treas. Reg. section 1.469-7 allows only income from lending transactions (i.e. interest income) to be treated as passive income. For other types of income, the court reiterated the doctrine that the passive activity loss rules were designed to limit a taxpayer's ability to use deductions from one activity to offset income from another activity.

CONCLUSION

The landscape for real estate investors has changed since the Tax Reform Act of 1986, and attorneys should notify their clients that tax benefits are limited. However, for some taxpayers who qualify as real estate professionals, there are still a few

opportunities that will allow them to net rental-related losses against other income. Furthermore, the recently issued regulations allow taxpayers to treat more income as passive income and thereby possibly utilize more deductions than before. Still, real estate investing and related passive losses remain a trap for the unwary. Guidance from a tax advisor is crucial.

HOW TO AVOID HAVING A TRUSTEE'S POWERS ATTRIBUTED TO THE DONOR

by Kathleen A. Stephenson and Edward Kessel, Philadelphia, PA

Among other things, PLR 200229013 revisits the question of whether the right to remove and replace a trustee will result in an otherwise irrevocable trust being included in either the estate of the settlor or the trust beneficiaries. The ruling reminds us that the Service still considers the completely unfettered right to remove and replace trustees as the equivalent of the retention by the settlor (or the beneficiaries) of the powers of the trustees. However, proper planning will avoid this conclusion.

In PLR 200229013, the trustee had discretion to make payments of income and principal to the grantor's children and other family members. The trust instrument provided that the trustees' discretionary powers over the distribution of income and principal could only be exercised by those trustees who were not currently eligible to receive such distributions, who did not have a legal obligation to support any beneficiary eligible to receive such distributions, and who were not a related or subordinate party with regard to the grantor.

The settlor's children replaced the unrelated corporate trustee with the Family Trust Company, a corporation they formed. The sole shareholder of the Family Trust Company was a corporation also formed by the settlor's children. The bylaws of the Family Trust Company provided that all distribution

decisions would be made by a "Distributions Committee" consisting solely of persons who are directors, but not employees, of the Family Trust Company, who are not "related or subordinate parties," and who have no beneficial interests in the trust. As we will see, this provision was key to avoiding inclusion in the estates of the beneficiaries.

The right of a trust beneficiary to appoint property to himself or herself is taxable as a general power of appointment under section 2041. If a beneficiary, at the time of death, has the unrestricted power to remove the trustee and appoint any other person, including himself or herself, the regulations provide that the powers of the trustee are deemed to be held by the beneficiary and are taxable in the beneficiary's estate. Reg. § 20.2041-1(b)(1). Similarly, sections 2036(a), and 2038 and the regulations thereunder will include property in the estate of a settlor or beneficiary as either a transfer with a retained life estate or as a power to alter, amend, revoke or terminate, if the trustee holds such powers and if the settlor or beneficiary holds the unrestricted power to remove the trustee and appoint any other person, *including himself or herself*.

The courts first looked at this issue in the income tax context. As early as 1944, the Sixth Circuit, overruling the Tax Court, found that a settlor's power to remove the corporate trustee in favor of another corporate trustee, did not reach that level of control over income and principal that would cause the trust to be treated as a grantor trust for income tax purposes. *Central National Bank v. Commissioner*, 141 F.2d 352 (6th Cir. 1944). The settlor had retained the right to advise the trustee on investments. The Sixth Circuit did not agree with the Tax Court that the trustee was likely to accede to the wishes of the settlor in order to protect its fees. Instead, the Sixth Circuit explained that an experienced trustee would be equally concerned with its liability to the trust beneficiaries for breach of trust. It therefore refused to treat the trust as a grantor trust. However, another trust was treated as a grantor trust

because the settlor retained right to direct (not just advise) the investments.

The Sixth Circuit revisited the issue in another income tax case, *Warren H. Corning v. Commissioner*, 239 F.2d 646 (6th Cir. 1956) holding that the settlor's retained right to remove and replace a trustee who had discretion to distribute income and principal gave the settlor control over the trust itself. The court focused on the discretionary power of the trustee with respect to income and principal and distinguished *Central National Bank* by noting that in that case the settlor merely retained the right to advise the trustee on investments, a right which alone would not cause the trust to be treated as a grantor trust. In response to the taxpayer's argument that the trust instrument should be construed to permit him to appoint only corporate trustees, the court stated that even were such a narrow reading to be given to the power, it would still permit the settlor to appoint a corporation of which he was the sole owner. Therefore, the settlor's power to remove and replace trustees was equated with a power to appoint himself.

In Rev. Rul. 79-353, 1979-2 CB 325, the Service followed *Corning*, holding that an unrestricted power to remove and replace trustees gave the taxpayer the powers of the trustee. (This ruling was slightly modified in Rev. Rul. 81-51, 1981-1 CB 458, which supports the holding of Rev. Rul. 79-353, but states that the ruling will not apply to additions made to a trust before October 29, 1979 if the trust was irrevocable as of October 28, 1979.) In PLR 8916032 the Service reiterated the premise that an unfettered power to remove and replace trustees will result in the powers of the trustee being attributed to the person holding the removal power for purposes of sections 2036, 2038 and 2041. To the consternation of trusts and estates practitioners, the Service has continued to pursue what it describes as "revolving door powers," assuming that even though the trustee must be "independent," the taxpayer could shop for trustees until finding one that would be willing to act as the taxpayer desired.

Restrictions on the right to replace the trustee, however, will save the day.

Thus, in Rev. Rul. 77-182, 1977-1 CB 273, the Service ruled that the retained power to appoint a successor trustee in the event of the trustee's resignation or removal by judicial process did not cause the trustee's powers to be attributed to the taxpayer. In *First Nat. Bank of Denver v. U.S.*, 648 F.2d 1286 (10th Cir. 1981), a beneficiary who could replace a corporate trustee which held a discretionary power of distribution over principal was not treated as holding the powers of trustee because he could only replace the trustee with another corporate trustee and could not appoint himself.

Thus, the law appeared to be that if the taxpayer could remove the trustee in favor of himself or herself, or in favor of a trustee he or she controlled, then the taxpayer would be treated as holding the powers of the trustee. If the ability to remove was subject to a condition that had not occurred (Rev. Rul. 77-182) or if the taxpayer could only appoint an independent trustee (*Central National Bank*) then the taxpayer would not be so treated. (*Corning* and *First National Bank of Denver* appear to conflict in that *Corning* could be read to allow the taxpayer to appoint as trustee a corporation which he or she controls, while *First National Bank of Denver* declines to reach this conclusion).

The Tax Court shut the revolving door (ability to hire and fire trustees until one who will accede to the settlor's wishes) theory in *Wall v. Commissioner*, 101 T.C. 300 (1993), where the court returned to a basic premise of trust law. Relying on *Bogart, The Law of Trusts and Trustees*, sections 543 and 42 (2d ed. 1993), the court stated: "The trustee has a duty to administer the trust in the sole interest of the beneficiary... In irrevocable trusts such as those under scrutiny, the trustee is accountable only to the beneficiaries, not to the settlor, and any right of action for breach of fiduciary duty lies in the beneficiaries, not in the settlor." The Tax Court also cited the District Court in *Byrum v. United States*, 311 F. Supp. 892 at 895 (D. Ohio 1970) for the proposition that "powers exercised by any successor corporate trustee [are] subject to scrutiny by a court of equity,

thus preventing abuse of the trustee's power in favor of [the settlor]." The Court thus found that the trustee's fiduciary duties to the beneficiaries of the trust trumped any duties it owed to the settlor and concluded that the property would not be included in the settlor's estate.

It was not until several years after *Wall* that the Service conceded that a power to remove and replace trustees at will does not in all events mean that the individual holding that power has retained the powers of the trustee. In Rev. Rul. 95-58, 1995-2 CB 191, the Service revoked Rev. Ruls. 79-353 and 82-51, and modified Rev. Rul. 77-182 to provide that "even if the decedent had possessed the power to remove the trustee and appoint an individual or corporate successor trustee that was not related or subordinate to the decedent (within the meaning of section 672(c)), the decedent would not have retained a trustee's discretionary control over trust income." (Emphasis added.)

The *Wall* case rests on the fiduciary responsibility of the trustees to the beneficiaries of the trust. The trustees would have such responsibility even if they were related to or subordinate to the settlor. Nevertheless, careful practitioners follow Rev. Rul. 95-58 and continue to restrict the right to remove and replace successor trustees to trustees who are not related or subordinate within the meaning of section 672(c). In PLR 200229013 the taxpayers wisely took the same approach. Even though they controlled the Family Trust Company through their ownership of the Family Corporation, they barred themselves and the employees of the Family Trust Company from serving on the Trust Company's distributions committee. The ruling correctly reaches the conclusion that retention of an unqualified power to remove a trustee and appoint a successor trustee who is not "related or subordinate to" within the meaning of section 672(c) is not considered a reservation of the trustee's discretionary powers for purposes of sections 2036 and 2038, nor does it constitute a reservation of a power of appointment under section 2041. ■

POINT & COUNTERPOINT: THE PROPOSED 12-MONTH RULE: A SOLOMONIC SOLUTION OR A VICTORY FOR THE FOXES?

INTRODUCTION: In *Indopco, Inc. v. Commissioner*, 503 U.S. 79, 87 (1992), the Supreme Court held that “a taxpayer’s realization of benefits beyond the year in which [an] expenditure is incurred is undeniably important in determining whether the appropriate tax treatment is immediate deduction or capitalization.” In the decade since then, debate has raged over the application of this principle, and successive Treasury Departments have promised guidance interpreting it. Last year, Treasury gave an Advance Notice that it intended to propose regulations that would allow the immediate deduction of prepayments, so long as the benefits from the prepayment expire within a year after the payment is made—whether or not those benefits expire within the same tax year as the expenditure. Announcement 2002-9, 2002-7 IRB 536. On December 19, 2002, Treasury issued Prop. Reg. §1.263-4(f), which provides what some have dubbed a 12-month rule, as described in the Announcement.

This edition’s Point-Counterpoint debates the merits of this rule. First, Calvin Johnson of the University of Texas argues that the rule is a serious conceptual error and even administratively worse than current law. In response, Ken Kempson and Ellen McElroy argue that such a rule is both conceptually defensible and administratively necessary.

POINT: A FOOL OR A FOX? THE CLEARLY ERRONEOUS ONE-YEAR RULE

by Calvin Johnson, Austin, TX

The Bush Administration’s proposed 12-month rule, Prop. Reg. section 1.263-4(f), is a serious error. A one-year prepayment is a short-term, profit-making investment properly capitalized under section 263.

In an income tax, investments create basis, rather than immediate deductions. Deductions are allowed only because the taxpayer has lost something, and prepayments, as their very name identifies, are not lost when they are paid. In accounting language, a prepayment is an “asset” on the balance sheet. Accountants use an “asset” as a vehicle to carry costs over to future years. A prepayment is carried over and deducted against income only as the prepayment expires. Some federal judges without an accounting background mistakenly think capital expenditures or assets are different in kind from expenses. But a capital expenditure or asset is nothing but a profit-motivated expense that has not yet stopped generating income.

Prepayments generate interest income. The wisdom of Code section 7872, which imputes additional interest between participants in below-market loans, is that interest *always* exists, although it might not have been stated. A taxpayer who makes a prepayment has given up the opportunity to earn interest, and transferred that opportunity to the recipient. Commercial parties offset this shift in opportunity by paying interest to the prepayer, either explicitly or in some disguised form.

A prepayment is thus like an interest-bearing CD. Announcement 2002-9 said that it would not apply its one-year rule to financial instruments, but at the level of abstraction at which financial analysis operates, all investments including prepayments are like bank accounts. A bank account is the universal measuring rod for all investments, because interest on a bank account is the only investment we truly understand.

Under the theory first enunciated by Professor E. Cary Brown, the ability to make an investment with excluded or deducted amounts is ordinarily as valuable as an exemption from tax for the subsequent income from the investment. Indeed, if tax rates drop, expensing of the CD principal is more valuable than later excluding the

interest on the CD from tax. This is a first-level tool of tax economics. Expensing matters a lot.

To illustrate the equivalence of exemption of income and expensing, assume that TP in the 40% tax bracket earns \$100, which TP will invest. In an income tax only take-home pay of $\$100 \cdot (1-t)$ or \$60 may be invested. Assume the investment doubles in value over period n , so that $\$100 \cdot (1-t) \cdot (1+i)^n$ or $\$60 \cdot 2 = \120 . Given an exemption for the yield, none of the \$120 is taxed. By comparison, the ability to deduct the investment means that the full gross salary of \$100 may be invested, and the pretax return will be $\$100 \cdot (1+i)^n$ or \$200. When the \$200 withdrawal is taxed at 40%, the result is $\$100 \cdot (1+i)^n \cdot (1-t)$ or $\$200 \cdot (1-40\%)$ or \$120, which is the same result as with yield exemption. More generally, yield exemption $\$100 \cdot (1-t) \cdot (1+i)^n$ equals principal deduction $\$100 \cdot (1+i)^n \cdot (1-t)$, for any i , n and constant t . If tax rates drop from 40% to 20%, the deduction of the principal will give TP $200 \cdot (1-20\%)$ or

\$160, which is better than yield exemption.

The function of the proposed 12-month rule is thus to exempt from taxation interest income that is like that on a short term CD. If the 12-month rule is put into effect, it will give everyone a year-end opportunity to avoid tax, just by paying next year's expenses this year. Since the Treasury has already largely exempted the recipient from tax on one-year prepayments received, the prepayment will fall into a lacuna in the law and disappear from the tax base entirely. This is a black hole, right here at home, and the Treasury will soon enough hear a giant sucking sound as the black hole pulls in its revenue.

In the Supplemental Information Treasury claims that the proposed 12-month rule will decrease administrative and compliance costs, but that is exactly wrong. The right rule in theory is to see if the benefits generated by an expenditure have expired at year end. If the cost has not expired but remains an interest-producing investment, it is properly an asset with basis and not yet a deduction. The proposed 12-month rule, however, would require that accountants and agents ascertain whether the cost will expire a year after they are made. Alas, one can never really know the future—or lie about it or audit it. Thus the 12-month line can never be certain. The accountants may not even know when the 12-month period starts. Already taxpayers are poised to overrun the 12-month line by arguing that they need to be able to deduct investments that *might* possibly expire a year after made and the proposed regulations respond with a truly unfathomable test of reasonable expectancy of renewal combined with an incomprehensible pooling method. The right theory—which asks whether there is still an investment at year end—is a far easier line for a responsible Treasury to administer and defend than a one-year-hence rule would be. The proposed rule will significantly increase compliance costs.

We all agree that *de minimis* issues should not be the subject of tax disputes. The Treasury, however, has announced an inadministrable rule—

the 12-month rule—to determine whether the amount is *de minimis* in the first place. The Treasury has not truly invented a way to avoid drawing a line, it has just replaced a clear line with an inadministrable line. Under the proposed rule, agents and taxpayers would need to spend time trying to determine whether something is too small to be worth accounting for, when it is really much easier to treat a prepayment correctly in the first place.

The proper *de minimis* level for tax purposes is defined by Code section 132(e): Is the accounting worth the tax involved? That standard leads to a very low threshold for capitalizing under section 263. Under the Cary Brown thesis, the expensing of an income-producing investment is tantamount to exemption of the subsequent return from the investment. Thus, the tax at issue is the tax on a CD that is like the prepayment. For a one-year prepaid expense investment, the threshold question becomes:

Whether the accounting cost of capitalizing (“CC”) is greater than the tax rate (“t”) times the rate of return on the expenditure (“R”) times the amount of the expenditure (“E”), or, Is $CC > t * R * E$?

With the corporate tax rate at 35% and CD interest rates, R, at 5%, the test for the threshold is whether $CC > .35 * .05 * E = 1.75\% * E$; hence, $E < 1/1.75\% CC$, or $E < 57.14 * CC$.

If I make the adverse assumption that it costs one dollar more of accounting expense to capitalize an expenditure for deduction next year than to expense it this year, then the tax at stake is worth more than the accounting cost for any expenditures “E” of more than \$57.14. If there is some possibility that the prepayment might give benefit for longer than a year, then the *de minimis* threshold is even lower.

In non-tax accounting, immaterial expenses are those that would not affect anyone's decision as to whether to invest in or buy the company. An expenditure that is a small fraction of

the worth of the whole company is not worth capitalizing. But for tax, the Treasury is not trying to buy the company, but just to collect tax from it. Thus, *de minimis* is determined just by comparing the tax involved with the cost of calculating it, not with the value of the overall company.

With computer accounting programs, it is as easy to debit an expenditure to an asset account, which will be picked up as in expense next year, as it is to debit the expenditure to an expense account deducted this year. The hard part is recording the expense for the accounting department to see, which is the same irrespective of its final categorization. Once the expenditure is recorded into the system it should be recorded correctly. For *prepayments*, there is nothing wrong with the elegantly simple rule that all prepayments worth recording at all are capital expenditures. End of controversy.

The proposed regulation also has no cap on the amount of a prepayment that can be expensed. We thus need to be looking at the very big, very material expenditures. The next EndRun or Line-Crossing Corporation that comes along will be able to deduct \$2 billion in prepayments at year end just to avoid tax this year. And next year they can do it again and with more. If next year's expenses have already been prepaid, then some lawyer will need to create some other interest bearing investment that avoids the financial instrument category and has a life of less than a year, and roll over all their taxable income with those. The worst abuses are those that are “regular and recurring.” With regular and recurring expenses, one can defer all tax indefinitely into the future and forever.

Prepayments need not even be cash: EndRun can incur a liability to make the prepayment, borrowing perhaps from the recipient itself. All that will ever be seen in the physical world will be offsetting electrons flowing back and forth, which will show a reported tax deduction for the prepayment and, to add insult to injury, also for interest incurred. Indeed you do not need to stroll beyond the bounds of current business ethics to wipe out all reported taxable income this year and forever, by

rolling over taxable income into the following year with liability-financed expenditures that will expire in less than a year. In sum, a Treasury that allows the expensing of expenditures that expire in less than a year is either a fool or a fox.

One can see traces of the fox in the hen house in these proposed regulations. The Treasury proposal would effectively allow the expensing of material investments, and allow clients to avoid what the Supreme Court called “the importance of a strong law of capitalization.” *Indopco*, 503 U.S. at 84 n. 4. It is relatively hard to find good tax avoidance on short-term and year-end investments that are like CDs, so these regulations would open new ground. The foxes seem to be taking the opportunity to eat out the tax base from the inside of the Treasury with the deduction of short-term investments. Given how badly we are going to need our federal tax base in the coming years, a responsible Treasury Department would not do that.

COUNTERPOINT: RESPONSE TO PROFESSOR JOHNSON

by Ken Kempson, Stamford, CT,
Ellen McElroy, Washington, DC,
and Glenn Walberg, Washington,
DC

In newly proposed regulations, the Treasury and Internal Revenue Service have provided a “12-month rule” excepting from capitalization those costs related to certain intangible assets with a life that does not extend beyond the earlier of (i) 12 months after the first date on which the taxpayer first realizes the right or benefit and (ii) the end of the taxable year following the taxable year in which payment is made. The rule does not apply to financial instruments, amortizable section 197 intangibles (e.g., intangibles such as goodwill and customer-based intangibles), or rights of indefinite duration. The proposed regulations caution taxpayers that the economic performance requirements of section 461(h) continue to apply to accrual-basis taxpayers.

Professor Calvin Johnson asserts forcefully that this proposed regime is ill-considered and will lead to massive hemorrhaging of the national fisc. Using mathematical models, a little humor, and possible hyperbole, he argues that the provision goes far beyond its stated purpose of reducing the administrative burden on taxpayers and the Service’s field personnel.

We disagree. While much of Professor Johnson’s analysis is true as far as it goes, we believe the regulations strike an appropriate balance between theoretical accounting purity and the true costs of compliance to both taxpayers and the Service.

First, the points of agreement: As a conceptual matter, costs should be capitalized to the extent they relate to taxable income recognized in a later period. Further, Professor Johnson’s math is correct in that the ability to deduct an investment is tantamount to making the return tax-exempt. Finally, administrative convenience justifies distortions only to the extent that the lost revenue is exceeded by the cost saved.

But there are a number of practical considerations that do not show up in the formulae, and we are not convinced that they have been applied correctly to the real world. Our discussion will take Professor Johnson’s points in order, and is deliciously free of legal citation since the issues are fundamentally theoretical, administrative, and practical. (For a more citation-laden treatment of these issues, please see the Comments on Announcement 2002-9 submitted by members of the Tax Accounting Committee of the ABA Section of Taxation, www.abanet.org/tax/pubpolicy/2002/.)

For analytical purposes, Professor Johnson likens an expense to the investment in an income-generating instrument, such as an interest-bearing CD. Since permitting an immediate deduction of the investment is the mathematical equivalent of not taxing the ultimate income, Professor Johnson concludes that the 12-month rule opens a huge hole in the tax system. He prefers the theoretical regime that asks only whether the benefits generated by the expense have expired at year-end.

First, it should be pointed out that the 12-month rule applies only where n (= the number of periods) equals one

or less. We say “or less” because the estimated tax rules normally would permit the taxpayer a mid-year partial benefit from the prior year expenditure since by definition it would have been fully deducted by the end of the next year. Thus, the government is not giving up as much as a pure annual model would predict.

A greater opportunity for abuse might be present if the rule applied to all expenditures, but the proposed regulations are not so generous. The 12-month rule would not apply to the very financial instruments that most neatly fit into the theoretical construct. The definition of these financial instruments is clearly crafted with an eye to covering all instruments that provide the taxpayer with a relatively certain (or ascertainable) income stream.

While enterprising practitioners will no doubt strive to manufacture a qualifying expenditure with a certain return, they are not likely to succeed and the government has reserved the ability to respond quickly to these efforts. Thus, the rule will most likely apply only to real expenditures with an uncertain marginal return. Exceptions, such as amounts paid to terminate a lessee’s rights when less than 12 months remain on the lease, are very hard to plan into a tax shelter.

Further, the economic performance rules of section 461(h) explicitly limit an accrual taxpayer’s ability to take into account many expenses, such as for goods and services that will not be shortly provided. The recurring item exception (applicable when economic performance occurs within 8 and one-half months after the close of a year) also requires that it results in a better matching of income and expense.

The considerations above indicate that the 12-month rule is not likely to generate a new tax shelter industry.

Professor Johnson’s other point is that the administrative burden avoided by taxpayers does not warrant this rule, even in the more ordinary case. We agree with his computation that avoided costs must be around two percent of an expenditure to justify, theoretically, application of this rule. But we think he has underestimated the costs that will be

INTERVIEW WITH ROBERT P. HANSON

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

INTRODUCTION: Rob Hanson recently served as the Tax Legislative Counsel in the Office of Tax Policy at the U.S. Treasury Department in the Bush Administration. He previously served as Tax Counsel to the U.S. Senate Committee on Finance. He has joined the National Tax Department of Ernst & Young LLP as a partner in its Mergers & Acquisitions Tax Services department.

Q Describe for us the various jobs you've had in the government.

A I feel very fortunate to have had the opportunity to spend two short stints in government. My first government job was on Capitol Hill in the early 90's, which lasted about two years, and, more recently, I worked in the Office of Tax Policy at Treasury for the past three years.

I was tax counsel to the Senate Finance Committee from 1993 through the early part of 1995. Senator Moynihan was the Chairman and Senator Packwood was the ranking member during most of my time on the Finance Committee, although they switched hats after the mid-term elections in 1994. I worked on several interesting and significant tax bills during my time on the Finance Committee, including the Budget Reconciliation Act of 1993. The 1993 Act, besides having the rather dubious distinction of being one of the largest tax increases in history, included a number of important tax provisions, such as the new mark-to-market provisions in section 475 and the provisions regarding amortization of goodwill and intangibles in section 197.

After the Finance Committee, I returned to private practice in Wash-

ington for about five years, until an opportunity came up to join the Treasury's Office of Tax Policy near the end of the Clinton Administration. I eventually held two different positions at Treasury. Initially, I took over as the Deputy Tax Legislative Counsel for Regulatory Affairs, which basically meant that I was responsible for coordinating Treasury's role in the development and review of all published guidance in the domestic area, other than employee benefits issues. Of course, issues in the domestic area frequently had international implications so we often worked with the International Tax Counsel and other lawyers in that office. As Deputy TLC, I focused exclusively on regulatory issues, so I really didn't have any role in the legislative area.

After the 2000 election, I stayed on as Deputy TLC with the Bush Administration and I eventually moved up to the position of Tax Legislative Counsel, which meant that I began to focus on the Administration's legislative initiatives in addition to published guidance. During my tenure the primary legislative items our office worked on were the Victims of Terrorism Tax Relief Act, which was passed near the end of 2001, and the economic stimulus bill (the Job Creation and Worker Assistance Act of 2002). Of course, Treasury is continually developing, reviewing and negotiating a broad range of tax bills, including Administration initiatives and bills introduced by members of Congress. The legislative process is incredibly dynamic. In effect, the role of the Tax Legislative Counsel, and the 15 to 20 lawyers that make up that Office, is to provide legal advice to the Assistant Secretary and Deputy Assistant Secretary for Tax Policy in two general areas, with respect to legislative initiatives that are being developed by the Administration or that may be pending before the Congress, and also with respect to



ROBERT P. HANSON

published guidance matters that the Treasury develops with the IRS.

Q Does the Office of Tax Legislative Counsel have much interaction with the IRS' Office of Chief Counsel?

A The lawyers and accountants in the Tax Legislative Counsel's office have daily contact with Chief Counsel lawyers, primarily dealing with the development and review of published guidance projects, although we also draw on the expertise of Chief Counsel lawyers with regard to various legislative initiatives. For example, as part of the Victims of Terrorism Tax Relief Act that I mentioned earlier, we worked very closely over several months with a team of Chief Counsel lawyers to develop a proposal that eventually was enacted as new code section 139, essentially codifying and rationalizing several decades of administrative pronouncements and rulings that had been issued under the rubric of the "general welfare" doctrine. The involvement of Chief Counsel lawyers, who have an enormous amount of experience in the day-to-day administration of the tax laws, resulted in a better statute that

was more carefully crafted to achieve what we needed to get done. As a general matter, I think it would be beneficial to the system for Treasury to bring IRS lawyers into the legislative arena more frequently. It's just common sense to involve in the legislative process the lawyers who will eventually have to administer the laws. It's not feasible to involve Chief Counsel in every legislative issue that arises, but I see a real benefit to the system as a whole if the IRS can play a more significant support role over time.

Chief Counsel also consults with Treasury on various litigation matters or even private rulings for individual taxpayers, but only to the extent that a particular litigation matter or ruling impacts guidance projects or otherwise involves questions of tax policy. By tax policy, I'm simply referring to issues that would have an impact on a broad range of taxpayers as opposed to the application of the law to the facts and circumstances of a particular taxpayer, which, of course, is the province of the IRS. It's been said on occasion, and it's undoubtedly true to some extent, that the closer a taxpayer comes to getting an adverse ruling from IRS the more it appears that an issue of tax policy is at stake. Perhaps that is why some practitioners try to use the Treasury as an appellate court when a ruling goes south. I'm not sure that's been a terribly effective strategy because that is not Treasury's role in the process.

Q You spent time at the Treasury Department under both the Clinton Administration and the Bush Administration. Can you describe any differences in approach or philosophy you saw during those two Administrations while you were at Treasury?

A The two Administrations, of course, shared a singular dedication to the development of a better tax system, fairer and more balanced for all taxpayers. At the same time, I don't think it's surprising to hear that there are philosophical differences in their respective approaches to tax policy or that there are differences in

their respective priorities, legislative and regulatory.

In terms of priorities, the Bush Administration focused early in the Administration on returning the budget surplus to taxpayers through an across-the-board tax cut. That was not the approach of the Clinton Administration, although how a Gore Administration would have dealt with the surplus is anyone's guess. A better example may be the manner in which the two Administrations have addressed the issue of abusive tax avoidance transactions. The Bush Administration has focused a great deal on disclosure, favoring a comprehensive disclosure regime (which was proposed in March 2001) over codification of economic substance or some other statutory standard that the courts would have to interpret over time. The basic notion of the disclosure regime is that if a taxpayer is willing to enter into a transaction and put it on his or her return, and an advisor is willing to write an opinion that the transaction works, then the taxpayer should be willing to disclose the transaction to the IRS. The Clinton Administration also looked for greater disclosure but did not think it was sufficient. In the end, the Clinton Administration relied much more heavily on legislative proposals that would codify the economic substance doctrine and increase penalties.

Q How would you compare and contrast the views on tax policy at the two ends of Constitution Avenue on which you have worked?

A That's a good question, but one that's difficult to answer because the two institutions, Congress and the Administration, are very different in terms of their basic organization and day-to-day functioning. I frequently hear practitioners say that tax policy decisions on the Hill, whether made by individual members, committees or the entire Congress, are "political." Well, it's true—they're political by nature. Members of Congress have constituents to represent and those interests have to be considered each time

they introduce a bill, co-sponsor a bill or vote on legislation, particularly when you have to be re-elected every 2 years, in the case of the House, or every 6 years, in the case of the Senate. That isn't to say that the Administration doesn't take politics into consideration or isn't political. Obviously, it is political because ultimately the President vetoes or signs tax legislation, and the Assistant Secretary for Tax Policy is a political appointee. Moreover, the Administration has its own legislative agenda that it wants to move through Congress.

Nevertheless, I think the Office of Tax Policy plays a special role in this context precisely because the Treasury isn't bound by a particular constituent's interest but, rather, at its best, protects good tax policy and acts as a thoughtful counter to the politics constantly swirling around the legislative process on Capitol Hill. Also, whether you're in a Republican administration or a Democratic administration, there are almost daily letters from members of Congress asking for Treasury's tax policy analysis on a whole range of legislative proposals. Answering these letters is one way that the Office of Tax Policy and the Administration goes on the record, because every letter that the Administration responds to, every letter that the Assistant Secretary signs, or in some cases, the Secretary signs, is a statement of tax policy. You have to understand the political posture of the sponsoring members, what their needs and interests are, and how those interests intersect with good tax policy.

Another aspect of the relationship between the Administration and the Congress that is obvious, but important, is that the Administration essentially puts out a blueprint of what it considers to be good tax policy in the form of a budget. That blueprint may be modified or changed during the course of the year, but it has the effect of putting the Administration on the record about its priorities and what it considers good tax policy. For example, in this year's budget, the Administration indicated that tax simplification would be a priority for the coming year. So, in the context of

the Administration's own initiatives and in reviewing congressional proposals, simplification had to be something that we were concerned about. In other words, the budget sets forth, or should set forth, a clear statement of what the Administration cares about. If tax simplification is what we care about, it would be difficult for the Office of Tax Policy to support legislation that would add significant complexity. I view the situation on Capitol Hill as being much more dynamic, with priorities changing more frequently. Also, it's basically impossible to describe a blueprint for any congressional session, particularly in the context of a politically divided Congress.

Q Where is the Administration on major changes to our current income tax system, like simplification and fundamental tax reform?

A There seems to be a consensus building that the current system has grown far too complex and unwieldy, not only for the average taxpayer to comply with, but also for the IRS to enforce, which is a topic that I believe Commissioner Rossotti touched on in his recent report to the IRS Oversight Board. There is no question that this Administration has been strongly supportive of simplification efforts and, as I mentioned earlier, the FY 2003 budget indicated that a significant amount of resources would be dedicated to producing simplification white papers on a broad range of topics. The first white paper suggested ways of crafting a single definition of child for all purposes of the code, and I know that many other white papers are in the pipeline. The Joint Committee on Taxation has done its own multi-volume study of simplification as well.

The problem with simplification, if you want to call it a problem, is not that there's any disagreement that simplification is needed. The problem is that it's not really a priority. It's on everyone's list of important tax policy objectives, but it's just never close enough to the top that it generates serious momentum. On the other

hand, if the Treasury is successful in getting out the remainder of its white papers in the next three to six months, and if the Administration includes simplification as a priority in the fiscal year 2004 budget, I'd be more hopeful that we could see some serious discussions during the first session of the next Congress. Also, I think the Administration should be applauded for some of the measures it has worked to implement administratively that I would call simplification, such as the e-filing initiative for Form 1040 and the attachments.

On the topic of fundamental tax reform, the Administration has been fairly clear that it has a strong interest in fundamental tax reform, although it's not something that is a short-term goal, at least not in the next year or two. That doesn't mean the Office of Tax Policy isn't doing the background work that would pave the way for a significant push down the road, because I think it's fairly clear that the Treasury is doing a lot of background work on fundamental reform.

Whether you're talking about major simplification of the current income tax system or more fundamental reform, the interesting question is whether the political stars can be aligned. The success of Tax Reform in 1986 was a result of the combined efforts of a popular President and consistent leadership from the tax-writing committees and congressional leaders. Those three constituencies have to be committed to the process and the ultimate goal. Until that happens, there will be a lot of background work, which is very useful, but not much possibility that either meaningful simplification or fundamental reform will be realized.

Q Some have suggested that there are basically two approaches to simplification; first, is one that in part has been pursued by the government up to now which is to make changes around the edges such as having a common definition of child. But, as your prior answer suggested, these kinds of changes are very difficult and may not get you any massive simplifi-

cation. One proposal that has come up again and again over the years is simply to remove millions of individuals from the income tax system by, for example, raising the standard deduction to \$200,000 and leaving the individual income tax in place as only a high-income surtax to make up the revenue loss. Do you see any chance of that type of simplification?

A That type of a system has been discussed in the context of various fundamental reform proposals. Whether that type of a simplified system could pass Congress is obviously a significant political question. My guess is that the distributional tables, depending on how the revenue loss is made up, wouldn't look particularly good. In other words, significant changes, even if they result in dramatic simplification, aren't going to get very far if there are dramatic winners and losers which this proposal would seem to generate.

Nonetheless, when you talk about significant reform you want to put everything on the table. The first step is to consider all your options. Removing millions of taxpayers from the rolls would be radical change but, again, the premise of fundamental reform is that radical change is desirable. Also, given the political process, you never know what options, from various proposals, could be combined to arrive at an acceptable compromise.

Q Some foreign taxpayers have suggested that one of the most troubling features of the U.S. tax system is not its complex structure or the aggressiveness of the tax administrator against foreigners, but rather its uncertainty. Does this surprise you and, if not, does the Treasury take this concern into consideration in planning tax policy?

A The comment does not surprise me because you hear the same comment from domestic taxpayers quite frequently. The comment is generally directed at the administrative

SPOTLIGHT ON COMMITTEES: STANDARDS OF TAX PRACTICE

by Donald Lan, Dallas, TX

The Standards of Tax Practice Committee focuses on the development and application of the ethical rules and obligations that apply to tax lawyers. Unlike other committees, the Standards Committee is concerned with the behavior of tax lawyers rather than with the operation of the substantive provisions of the Code. The work of the Committee ranges from sponsoring programs in which responses to ethical quandaries are discussed, to providing comments on amendments to Circular 230. The Committee has participated in numerous initiatives affecting tax lawyers, such as the proposed changes to the ABA Model Rules of Professional Conduct (including Ethics 2000) and the development of the *Law Governing Lawyers* treatise. The Committee is proud to enjoy a good relationship with the Service's Office of Director of Practice, and the Director of Practice frequently attends Committee meetings to share information on the work of that Office.

The Committee is also responsible for developing and drafting *Statements of Standards of Tax Practice*. The *Statements* provide guidance on ethical issues that arise in practice. Once approved by the Section Council, the *Statements* are published in *The Tax Lawyer*. The first *Statement*, for instance, addressed the issue of a

tax lawyer's obligation to disclose computational errors made by the Internal Revenue Service in tax controversies, both administratively and in litigation. Surprisingly, although this issue arises often, there was little guidance on point. Another published *Statement* discusses the differing standards of conduct respecting the civil penalties applicable to tax lawyers and their clients, and gives guidance on the lawyer's obligations when such standards diverge.

The Committee is often asked to participate in projects with other Section committees. Recently, Committee members assisted in drafting comments on the legislative and regulatory proposals dealing with registered and listed transactions. Together with the Employee Benefits Committee, the Committee cosponsored a mini-program on the ethical obligations of ERISA lawyers. In addition, the Committee has worked closely with the Committee on Civil and Criminal Penalties to produce a program on ethical issues arising from the Enron scandal and a two-part program on the Sarbanes-Oxley Act of 2002. This two-part program will be presented at the Section's 2003 Midyear meeting in San Antonio.

At each of its meetings over the past several years, the Committee has focused on a particular ABA Model

Rule of Professional Conduct, providing an in-depth analysis of the rule as it may relate to the practice of tax law. On occasion, Committee meetings have focused on ethical issues that arise in specific areas of practice, such as estate planning or the submission of offers-in-compromise, using hypotheticals based on real-life situations to explore potential responses. The Committee is proud to attract nationally recognized speakers from private practice, academia and the government on these important subjects; Section and national stalwarts, such as the late Fred Corneel, have been active members of the Committee and contributed much to its activities. Committee programs offer valuable continuing legal education, and provide ethics credit required by most states.

Although the Committee has a sizable membership, it is always ready to welcome additional members. The Committee is also soliciting new and existing members to be more active in on-going projects. The current chair of the Standards Committee is Donald Lan of Dallas, Texas, and the vice-chair is Professor Michael Lang of Orange, California. For more information on the Standards Committee, please feel free to contact Don at 972/386-8500 or at dlan@ksmdallas.com or Mike at 714/628-2547 or at mlang@chapman.edu. ■

REMINDER: Section members may apply to join committees with the new 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 has rescinded its *One Committee Rule*. Section Members now may join as many committees as they like.

2003 MAY MEETING

MAY 8-10, 2003, WASHINGTON, DC

GENERAL INFORMATION

Washington, DC welcomes the Section of Taxation to the 2003 May Meeting, May 8 – 10th. Join us and take advantage of the opportunity to meet with the country's leading tax attorneys and government officials to discuss the latest federal tax policy initiatives, regulations, legislative forecasts, and planning ideas. The Grand Hyatt Washington will again serve as the Section of Taxation's Headquarters Hotel. In addition, a special block of rooms has been reserved at the nearby Marriott Metro Center.

DRESS CASUAL

The dress for the 2003 May Meeting is casual, so relax and bring comfortable attire.

REGISTRATION

Any Section member attending any part of the 2003 May Meeting, whether or not he or she speaks, must register and pay the registration fee. Shared registrations are not permitted. Companions are defined as non-Section members not attending substantive meetings. Any companion attending substantive programs must register and pay either the Section member or non-Section member registration fee, whichever is applicable.

The Section is pleased to offer a 15% discount to advance registrants. To register for the 2003 May Meeting, please use the Meeting Registration and Ticket Purchase Form in this *NewsQuarterly* or on our website www.abanet.org/tax. **The final deadline for advance registration is April 3, 2003.**

The registration fee includes one set of meeting materials and permits registrants to attend all meetings, sessions and programs; however, it does not include meal functions and social events listed as "Ticketed Event." All tickets are sold on a first-come, first-served basis. Payment may be made by check or credit card. The Section accepts American Express, Master Card and VISA. **No registration will be processed or considered received unless payment is included.**

The Meeting Registration and Ticket Purchase Form, along with full payment,

must be faxed or postmarked by April 3, 2003, for the discounted advance registration fee and airline ticket raffle. Registrations will be accepted after the April 3 deadline date (until April 30, 2003); however, they will be automatically processed with the "on-site" fee. Please note that all registrants including those who register between April 3, 2003, and April 30, 2003, will pick up their badge and meeting materials at the advance registration area in Washington.

REGISTRATION FEE WAIVED

The 2003 May Meeting registration fee will be waived for Tax Section members who have never attended a Tax Section meeting and for law students and LL.M. candidates. Meeting benefits include Continuing Legal Education programs, legal publications, professional development, networking and access to up-to-date information. To register, use the Meeting Registration and Ticket Purchase Form in this *NewsQuarterly* or visit our website: www.abanet.org/tax.

REFUND POLICY

All cancellations and refund requests must be received in writing and be postmarked or faxed by April 3, 2003, to receive a refund. All refund requests will incur a \$50 cancellation fee. Absolutely no refunds will be granted at the meeting. Please direct all refund requests to the Meeting Registrar at the Section Office.

ON-SITE REGISTRATION AND TICKET PURCHASE HOURS

The Registration Desk will be open at the May Meeting during the following hours:

Thursday	12:00pm – 9:00pm
Friday	6:30am – 6:30pm
Saturday	6:30am – 4:00pm

WIN A FREE AIRLINE TICKET

At the May Meeting, two meeting attendees will each win a roundtrip airline ticket for travel within the continen-

tal United States good for one year. All complete registrations postmarked or faxed by April 3, 2003, will be eligible. A drawing for the winners will take place during the Section Plenary Session at the May Meeting. Attendees do not have to be present at the Plenary Session to win.

AIR TRAVEL INFORMATION

American, Delta and USAirways are the preferred airlines for the 2003 May Meeting. To make airline reservations or to compare rate information, attendees should contact the airlines directly using the ABA reference numbers provided below.

American Airlines
1-800-433-1790
Reference: 15794

Delta
1-800-241-6760
Reference: 189408A

US Airways
1-877-874-7687
Reference: 36632473

Attendees are encouraged to compare all options available, including rates and restrictions between an airline's own zone fares and the ABA rates. The ABA rates are available through your travel agent, directly from the airline, or from the ABA travel agency, Tower Travel Management at 1-800-921-9190.

CAR RENTAL INFORMATION

ABA Members can receive special rates through Hertz. Call 1-800-654-2230 and mention the ABA/Hertz reference number CV022R0637; TDD users dial 1-800-654-2280. You will be asked for your ABA membership ID number at the time of rental.

CHILD CARE SERVICES

If you need childcare services, contact the concierge in the hotel where you are registered.

MEETING MATERIALS

The Section Program Meeting Materials will be available at the May Meeting in print form and on CD-ROM in PDF and MS Word formats. You will receive the format based on what was indicated on your Meeting Registration and Ticket Purchase Form. Please note that the *Meeting Materials* contain only the material for the Saturday Plenary Session and Section Programs. The materials from selected Committee Programs will be compiled and made available following the meeting. Both the *Meeting Materials* and *Selected Committee Handouts* print publications are available by subscription and for purchase separately.

In addition, all meeting materials, including committee program materials, will be available on Comm-Online—an innovative Tax Section and LexisNexis joint project which gives members no-cost online access to hundreds of pages of Section Program and Committee Meeting Materials. This service is available on the Section's website www.abanet.org/tax/commonline/.

HOTEL RESERVATIONS

Those wishing to make reservations at the Grand Hyatt or Marriott Metro Center may do so by using the Hotel Reservation Form located in this *NewsQuarterly* or on our website www.abanet.org/tax.

The deadline for making reservations is Friday, April 4, 2003. Please note that the Hotel Reservation Form should be sent directly to the hotel, not to the Section Office.

CLE AND ETHICS CREDIT

NOTE: You must be registered for the meeting in order to be eligible to receive CLE or ethics credit. Accreditation will be requested for this meeting from every state with mandatory continuing legal education (MCLE) requirements for lawyers. Each state has its own rules and regulations, including its definition of "CLE." The Uniform Certificate of Attendance will be available at the meeting for both attendees and speakers and will be included with the Tax Section Meeting Materials. The Section will request CLE credit for subcommittee meetings that include a program description and names of panelists. Eligible subcommittees will

be listed on the Uniform Certificate of Attendance. Please call the ABA CLE Department in Chicago at 312/988-6217 with any questions pertaining to the number of credit hours granted by each state.

REQUIREMENTS FOR NEW YORK ATTORNEYS: Attendees seeking New York CLE credit are responsible for signing in and out of each session they attend and for filling out a New York Certificate of Attendance Form. The sign-in and out forms will be available in each meeting room, and the Certificate of Attendance Form will be available at the CLE Information Booth during the Meeting. In order to receive full credit for all sessions attended, attendees must stop by the CLE Information Booth before leaving the Meeting to obtain an authorization signature from an ABA staff member.

AUDIO TAPES

Audiocassette tapes of committee and Section programs will be available for purchase onsite as well as after the meeting. Provided by Teach'em, each program typically consists of two cassettes and costs only \$20. To place an order, contact Teach'em at 1-800-776-5454 or info@Teachem.org, or www.Teachem.net/ABA.

SECTION EXHIBIT

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

SECTION LUNCHEON AND RECEPTION

The Section Reception will take place on Friday, May 9, from 6:30pm to 8:00pm, and the Section Luncheon will be held on Saturday, May 10 from 11:45am to 12:40pm. Both events will be held at the Grand Hyatt.

PROGRAM SCHEDULE

For the complete 2003 May Meeting Program Schedule, including dates and times, visit the Tax Section website beginning in March at www.abanet.org/tax/.

ACTIVITIES

FRIDAY, MAY 9
9:00am – 1:45pm
L'ACADEMIE DE CUISINE
5021 Wilson Lane, Bethesda, MD
(Ticketed Event: \$80)

Two cooking classes at L'Academie de Cuisine in Bethesda, MD will be offered. L'Academie de Cuisine was founded in 1976 by Francois Dionot of Reims, France, who has had 30 years of experience in highly acclaimed kitchens in Switzerland, France, New York and Washington.

One class will be a step-by-step cooking demonstration where participants will watch as a chef from L'Academie de Cuisine prepares "Foods for Entertaining." The second class will be hands-on, where the participants will prepare "Sweet & Savory Tarts" under the guidance of an L'Academie de Cuisine pastry chef. Each group will be served lunch separately in their own classroom and will taste the prepared foods. Recipes from both sessions will be distributed to all participants.

The cost of the event includes round trip transportation between the Grand Hyatt and L'Academie de Cuisine. Buses will depart promptly at 9:00am from the Grant Hyatt and the classes begin at 10:00am. Parking is available at nearby public garages.

Tickets may be ordered by using the Registration and Ticket Purchase Form found in this *NewsQuarterly*. **Please choose either the participation or demonstration class on the registration form. In the event that the class you select is sold out, please indicate on the registration form whether you would prefer to be assigned to the other class or receive a refund.**

Tickets are sold on a first-come, first-served basis. Only a limited number of attendees will be able to participate. We encourage you to register as early as possible for this event.

ABRA SPONSORSHIP

The Section of Taxation would like to thank the American Bar Retirement Association (ABRA) for its generous contribution in support of the May Meeting. The ABA Members Retirement Program, sponsored by ABRA, and offered by prospectus by State Street Bank & Trust Company of Boston, is designed to meet the retirement planning needs of law firms. ■

2003 SECTION OF TAXATION MAY MEETING REGISTRATION AND TICKET PURCHASE FORM

*Advance registration with full payment must be postmarked or faxed by April 3, 2003.
CANCELLATIONS: \$50, NO REFUNDS after April 3, 2003.*

INFORMATION

(Please type or print clearly.)

Attendee Name: _____

ABA ID No.: _____

Please check here if you need CLE Credit in one of the following states:

NY PA TX DE

Companion Name: _____

Firm or Agency: _____

Business Address: _____

City/State/Zip: _____

Daytime Telephone: _____

Fax: _____

E-mail: _____

Home Address: _____

City/State/Zip: _____

Please check here, if under the Americans with Disabilities Act, you require specific aids or services during your visit to the Tax Section Meeting. Audio Visual Mobile

Do not send me promotional information from sponsors and other vendors.

REGISTRATION

If Postmarked or Faxed	by	after
	4/3/03	4/3/03

Check one:

Regular Member/Associate \$350 \$400

Foreign Lawyer \$350 \$400

Young Lawyer (admitted to the Bar less than 3 years) \$250 \$295

Full-Time Law Professor \$95 \$105

Government Official \$95 \$105

Full-Time LITC Employees \$95 \$105

Non-Section Member* \$400 \$450

*ABA members registering will become Tax Section members for 2002-2003.

Full-Time J.D./LL.M. Candidate waived waived

First Time Tax Section Attendee** waived waived

**First Time Tax Section Attendees must attest to the following two requirements to qualify for the waived fee.

Yes, I am an ABA Tax Section Member.

Yes, this is the first Tax Section meeting I have attended.

Check one: Registrants will receive one version of the meeting materials.

Traditional book version only (included in registration fee)

CD-ROM only (Windows version) (included in registration fee)

Traditional book version with CD-ROM (additional \$60 Charge)

UNABLE TO ATTEND THE MEETING?

Mail the following materials after the Meeting:

Meeting Materials CD-ROM \$60.00 + \$5.95 S/H

Meeting Materials traditional book version \$65.00 + \$5.95 S/H

Selected Committee Handouts \$75.00 + \$5.95 S/H

NOTE: Meeting Materials contain only the materials for the Saturday Plenary Session and Section programs.

TOTAL: \$ _____

TICKETED EVENTS

FRIDAY, MAY 9

TOUR/ACTIVITY – L'Academie de Cuisine

If the class I choose below is full:

Assign me to the other class; or

Refund the \$80.

1 Participation Class _____ at \$80 each = \$ _____

2 Demonstration Class _____ at \$80 each = \$ _____

COMMITTEE LUNCHEONS

3 Administrative Practice and Court Procedure & Practice _____ at \$48 each = \$ _____

4 Agriculture _____ at \$48 each = \$ _____

5 Banking & Savings, Financial Transactions, Insurance Companies, Regulated Investment Companies and Tax Exempt Financing _____ at \$48 each = \$ _____

6 Civil & Criminal Tax Penalties _____ at \$48 each = \$ _____

7 Corporate Tax and Affiliated & Related Corporations _____ at \$48 each = \$ _____

8 Estate & Gift Taxes and Fiduciary Income Tax _____ at \$48 each = \$ _____

9 Exempt Organizations _____ at \$48 each = \$ _____

10 FAUST, FLE, Transfer Pricing and USAFTT _____ at \$48 each = \$ _____

11 Partnerships and Real Estate _____ at \$48 each = \$ _____

12 S Corporations _____ at \$48 each = \$ _____

13 State & Local Taxes _____ at \$48 each = \$ _____

RECEPTION

14 Section Reception _____ at \$72 each = \$ _____

SATURDAY, MAY 10

COMMITTEE BREAKFAST

15 Partnerships, Real Estate and S Corporations _____ at \$32 each = \$ _____

LUNCHEON

16 Section Luncheon _____ at \$45 each = \$ _____

PAYMENT INFORMATION

TOTALS:

Registration Fee \$ _____

Additional CD-ROM \$ _____

Ticket Total \$ _____

TOTAL PAYMENT: \$ _____

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

Check One: Master Card VISA AmEx

CARD NO.: _____

EXP. DATE: _____

SIGNATURE: _____

Return to:

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

BY:
APRIL 3
2003

For Tax Section Use Only
(AD 12-6: P4)

Check # _____

Amount Rec'd \$ _____

Initials _____

SECTION OF TAXATION MAY MEETING 2003 MAY MEETING HOTEL RESERVATION FORM

*Please complete the FORM and return to the HOTEL directly
DO NOT RETURN THIS FORM TO THE TAX SECTION OFFICE!*
RETURN FORM TO HOTEL BY FRIDAY, APRIL 4, 2003

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

Group: ABA Section of Taxation
Group Dates: 5/7/03 - 5/12/03

Name _____
Co-Affiliation _____
Address _____
City _____
State _____ Zip _____
Phone _____
Fax _____

Room Requests

Non-Smoking Room
 Handicapped Accessible Room

Arrival Date _____ Departure Date _____
Arrival Time ____ a.m. ____ p.m.

Payment Information

VISA MasterCard American Express

Card No. _____

Exp. Date _____

Signature _____

Check enclosed \$ _____

Confirmation Requested via facsimile

Grand Hyatt Washington SECTION HEADQUARTERS

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

	Convention Rates	Business Plan*	RC**
Single Occupancy	\$219	\$239	\$254
Double Occupancy	\$235	\$255	\$270

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

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

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

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

King Bed 2 Double Beds

Marriott Metro Center

775 12th Street, NW
Washington, DC 20005
Tel: 800/228-9290 or 202/737-2200
Fax: 202/626-6943

Make checks payable to "Marriott Metro Center"

Single/Double Occupancy **\$219**

King Bed or 2 Double beds

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

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

GOVERNMENT SUBMISSIONS BOX SCORE

Since the last issue of the *NewsQuarterly*, the Tax Section has coordinated the following Government Submissions, which can be viewed and downloaded free of charge from the Section's website at abanet.org/tax/pubpolicy/regindex.html. If you have any questions or need assistance in locating these documents, please contact the Tax Section office at (202) 662-1783.

I.R.C. §	DATE	TITLE	COMMITTEE	CONTACT
263(a)	9/26/02	Comments Concerning Capitalization Issues Regarding Expenditures Incurred in Acquiring, Creating or Enhancing Intangible Assets	Tax Accounting	Kenneth Kempson, Bradley M. Borden, Erik Jensen, and Leslie M. Schneider
4958	10/2/02	Comments Pursuant to Internal Revenue Service Announcement 2002-47 on Possible Amendments to Regulations Governing Chapter 42 Excise Taxes	Exempt Organizations	Victoria B. Bjorklund, Paul H. Feinberg and Lisa L. Johnson
141, 142	10/14/02	Recommendation to Modify Remedial Action Regulations	Tax-Exempt Financing	Clifford M. Gerber
4980F	11/8/02	Comments Concerning Proposed Regulations Under Section 4980F of the Code	Employee Benefits	Pam Scott, W. Andrew Douglass, Robert Miller, Marc Sandberg, Richard Sanderson, and Robert B. Stevenson
338, 1060	11/18/02	Comments Concerning Proposed Regulations Under IRC Sections 338(h)(10) and 1060 as Applicable to Insurance Companies	Insurance Companies	Michael A. Bell and Christopher W. Schoen
355	11/18/02	Comments Concerning the Revised Proposed and Temporary Regulations Under Section 355(e) to Define a "Plan (or Series of Related Transactions)"	Corporate Tax	Donald P. Hansel and M. Todd Prewett
501(c)(3)	12/2/02	Comments Pursuant to Internal Revenue Service Announcement 2002-92, 2002-41 I.R.B. 709 on Proposed Revisions to IRS Form 1023 and Instructions	Exempt Organizations	Eve Borenstein, LaVerne Woods, and Betsy Buchalter Adler
61, 7872	12/31/02	Comments Concerning Proposed Regulations on Split-Dollar Life Insurance	Various from Sections of Taxation and Real Property, Probate and Trust Law	Andrew C. Liazos

FUTURE SECTION MEETINGS

- 2003 MAY MEETING—MAY 8-10, GRAND HYATT, WASHINGTON, DC
- 2003 FALL MEETING—SEPTEMBER 11-13, SHERATON CHICAGO, IL
- 2004 MIDYEAR MEETING—JANUARY 29-31, GAYLORD PALMS HOTEL, KISSIMEE, FL
- 2004 MAY MEETING—MAY 6-8, GRAND HYATT, WASHINGTON, DC
- 2004 FALL MEETING—SEPTEMBER 30-OCTOBER 2, SHERATON, BOSTON, MA
- 2005 MIDYEAR MEETING—JANUARY 20-22, MANCHESTER GRAND HYATT, SAN DIEGO, CA
- 2005 MAY MEETING—MAY 19-21, GRAND HYATT, WASHINGTON, DC
- 2005 FALL MEETING—SEPTEMBER 15-17, PARK HYATT & HYATT REGENCY, SAN FRANCISCO, CA

NEWS BRIEFS

ABA CONNECTION OFFERS 3-TAPE TAX PACKAGE

This 3-tape ABA Connection Collection Tax Package includes “Good News in Tax Law,” “Tax Outcomes You Didn’t Expect,” and “Dealing with the IRS.” **Good News in Tax Law** discusses how new legislation and rulings by the courts and the Service often produce beneficial results for taxpayers—if they know how to use them. **Tax Outcomes You Didn’t Expect** focuses on the Internal Revenue Code, which is full of surprises—many of them costly to an unsuspecting taxpayer. This program identifies where some of the biggest surprises are, how they can increase a tax bill, and what steps to take to minimize their impact. **Dealing with the IRS** covers topics on the restructuring scheme of the IRS; what to do when a client is notified of a tax audit; ramifications of filing a joint return; extended confidentiality privilege; and what to do when an audit happens to you. This 3-tape package is only \$115 for ABA Members, \$170 for non-members. To place an order, call 800/285-2221 or visit the ABA CLE website at www.abanet.org/cle/. **ABA Product Code:** J01CCTA **Authors:** Carol F. Burger, Samuel L. Braunstein, Thomas A. Jorgensen, Michael Yopp,

James T. Fuller, Patricia L. Brown, Lisa Talley.

TAX LINK LIVE

The Tax Section’s December 2002 “Tax Link Live” CLE telecast is past, but Section members still can hear a free audio recording of the program “What Engagement Letter?” over the web. The panel, which included tax lawyers from solo practices and small and mid-size firms, discussed numerous practical and ethical issues involved in a tax attorney’s undertaking the representation of new clients, including the pros and cons of various styles of engagement letters used in diverse areas of tax practice. For details, go to the Section’s website at www.abanet.org/tax.

LAW STUDENT TAX CHALLENGE

The semifinalist teams for the Young Lawyers Forum’s Second Annual Law Student Tax Challenge have been announced. The semifinals and finals will take place in San Antonio at the Section’s 2003 Midyear Meeting. The Law Student Tax Challenge (the “Tax Challenge”) is an annual inter-law school transactional planning and client counseling competition sponsored by the ABA Tax Section’s Young Lawyers Forum. The Tax Challenge is

designed to focus on the tax consequences of a complex business-planning problem, and is intended to provide law students with the opportunity to research some “real life” tax planning issues and to demonstrate their acquired tax knowledge, through their writing and oratory skills, in front of the nation’s largest single group of practicing attorneys, judges, consultants, and educators specializing in federal tax law. For more details, visit the YLF webpage at www.abanet.org/tax/groups/ylf/.

INTERNATIONAL TAX PROGRAM IN PARIS

Mark your calendar for the ABA/IBA international tax program, **U.S.-European Tax Strategies for Multinationals**, which will be held on March 14, 2003 at the Société Générale, Paris, France. This one-day program will address international tax issues for a wide range of practitioners, review foreign country laws and provide insight into local law planning issues. The program includes four panels: *Current Issues in Cross-Border Tax Discrimination—Treaty and Supranational Legal Remedies*; *Tax Efficient Repatriations from Foreign Affiliates*; *Tax Arbitrage Transactions*; and *Mergers and Acquisitions*. Download the program and registration information from the Tax Section’s website at www.abanet.org/tax. ■

A quick way to view
ABA Section of Taxation
Committee Meeting Materials...

Comm-Online

Comm-Online.

www.abanet.org/tax/commonline

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Committee Meeting Materials
and more, powered by the

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INTERVIEW WITH ROBERT P. HANSON

FROM PAGE 22

rulemaking process, which I'm sure is one of the reasons that Congress amended section 7805(b) in 1996 so that retroactive rulemaking is generally only allowed to "prevent abuse" in the language of the code. Part of the answer is certainly to issue more guidance on a timelier basis, but that's nothing new. Each Administration comes in with that goal in mind. I think we've made progress in recent years with some creative new programs that IRS Chief Counsel and Treasury have developed in tandem. That's also clearly the notion behind the new push to issue more revenue rulings on discreet issues rather than wait for comprehensive regulations to work their way through the notice and comment period and finalization. I think that's also the rationale behind the new quarterly updates to the Treasury/IRS business plan: timeliness and also being certain that limited resources are focused on the most relevant projects. The quarterly updates provide much needed flexibility in the guidance process, allowing Treasury and IRS the ability to reprioritize more than once each year. Also, Treasury Secretary O'Neill was a big proponent of issuing timely guidance, so you can imagine that was a priority of ours as well.

Uncertainty in the law also leads, at some level, to more controversy and litigation and I'm not sure it's in the best interest of the government or taxpayers to make law through the courts. Litigation is inevitable in some cases because the economy is enormously complex and it's basically impossible to write rules to cover each and every situation. Nevertheless, it's clearly preferable to provide clear, simple guidance on a timely basis.

Q Do you have any thoughts on Commissioner Rossotti's recent statement that the IRS is "winning the battle, but losing the war"?

A I believe that comment was made in the context of the Com-

missioner's final report to the IRS Oversight Board on the current state of the IRS. The thrust of his comment, in the overall context of a lengthy report, is that he is generally optimistic about improvements in the performance of the IRS that have occurred over the last five years, but, at the same time, he identified certain troubling trends that still need to be addressed. I think the report mentioned tax code complexity and the proliferation of abusive tax avoidance transactions as the kinds of systemic problems that need to be addressed in order for IRS to accomplish its mission. As we talked about earlier, tax code complexity adds to the cost of compliance for taxpayers and makes it more difficult and costly for IRS to enforce the tax laws. In that sense, I think it's clear that many taxpayers share the Commissioner's frustration with an increasingly complex tax code that ultimately reduces voluntary compliance at some level.

I completely agree that tax simplification is a worthy undertaking, and the Treasury should be applauded for continuing its work on simplification, but the ultimate success of simplification is difficult to predict for all the reasons we talked about earlier, although the primary reason, in my view, that simplification never seems to generate the necessary momentum is that other priorities inevitably seem to crowd it out. I would also agree with the notion that it's bad for the system if there is a perception that some taxpayers aren't contributing their fair share because of abusive tax avoidance transactions or because the IRS isn't adequately enforcing the law. It creates an atmosphere of disrespect for the tax system as a whole and also contributes to non-compliance. An IRS that is fair, efficient and effective in administering and enforcing the laws is an essential part of our system.

Q You have practiced your entire career here in Washington with two short stints in the government.

Can you comment on the value of government service?

A I'm a big believer in government service as something that is clearly beneficial for the individual practitioner as well as the government. A practitioner who decides to join the government brings with him or her an understanding of and perspective on the marketplace that can be very important to the government's mission. Likewise, I think that practitioners who spend time in government gain a very useful perspective on how the system works and, maybe more importantly, I think it's very helpful for practitioners to gain an appreciation of the many challenges facing the government in the development and the administration of the tax law. In particular, I would encourage young lawyers and accountants to think about government as part of their individual career paths, whether their particular interest lies in the political landscape on Capitol Hill, in the regulatory world of the IRS and Treasury or in litigating cases at the Department of Justice. Most people that I've run across think of their time in government as a career highlight.

Q You have previously served with distinction as an interviewer and editor of the *NewsQuarterly* and we want to thank you very much for letting us turn the tables on you. How does it feel to be answering, rather than asking, the questions?

A Over the years, the *NewsQuarterly* has interviewed some very distinguished persons both in and out of government, so it's very flattering to be asked to comment on the issues of the day and, overall, it's fun to be on this side of the table. Tax policy is a compelling and dynamic area of the law that is constantly evolving. I think that's the primary reason that so many practitioners, including myself, decide to spend a few years in government service, whether it's at the Treasury, IRS, or on the Hill. ■

ABA SECTION OF TAXATION MATERIALS ORDER FORM

Made possible through a partnership with LexisNexis™, the Section of Taxation is pleased to present *Comm-Online*—a searchable database of committee meeting materials on the web. This service is a no-cost benefit to Section of Taxation members. For more information, visit our website www.abanet.org/tax.

Please check off all desired materials and complete the following order form. Please note that these materials, as well as all other Section publications, can be ordered directly from the ABA Service Center, tel. 800/285-2221.

2002 FALL MEETING SECTION PROGRAMS

- ENTIRE VOLUME OF 2002 FALL MEETING SECTION PROGRAMS (PC 5470541) \$65
- HIPAA PRIVACY PRIMER FOR GROUP HEALTH PLANS (PC 547051043) \$20
- A NEW ROAD TO SUCCESSFUL CASE RESOLUTION (PC 547051044) \$20

2002 FALL MEETING SELECTED COMMITTEE HANDOUTS

- ENTIRE VOLUME OF 2002 FALL MEETING SELECTED COMMITTEE HANDOUTS (PC 5470544) \$75
- AGRICULTURE Farmer Cooperatives—An Overview (PC 547051024) \$15
- BANKING AND SAVINGS INSTITUTIONS 2002 Developments (PC 547051025) \$25
- CIVIL AND CRIMINAL TAX PENALTIES Attorney-Client and Constitutional Privileges (PC 547051026) \$8
- CLOSELY HELD BUSINESSES Conflict Issues in Formation and Disposition of the Closely Held Business Entity; Conflicts and Ethical Issues Involved in Representing the Closely-Held Business; Avoiding the Frying Pan and the Fire; Retaining and Rewarding Top Managers of Closely Held Businesses (PC 547051027) \$30
- CORPORATE TAX A Primer on IRC Section 83; Contingent Consideration and Contingent Liabilities in Acquisitions—Outline; Corporate Tax Committee Recent Developments; Escrows, Earn-outs, and Other Contingent Payment Arrangements in Taxable Transactions—Examples (PC 547051028) \$40
- COURT PROCEDURE AND PRACTICE Summary of Current Developments: May 9–October 16, 2002 (PC 547051029) \$8
- EMPLOYEE BENEFITS Distribution Planning for Retirement Plan Assets; Miscellaneous Issues Affecting Qualified Domestic Relations Orders; Retroactive QDRO Issues; Sarbanes-Oxley Act Interpretive Issues Under Section 402-Prohibition of Certain Insider Loans; The Big Split: What's Happening With Split Dollar Benefits?; Unique Issues Regarding Estate Planning with IRAs (PC 547051030) \$35
- ESTATE AND GIFT TAXES The Economic Growth and Tax Relief Reconciliation Act of 2001—To Do (Or Not To Do) List—; Selected Recent Developments in Income, Estate, Gift and Generation-Skipping Transfer Tax; The Inheritance Trust: Multigenerational Planning From the Bottom Up (PC 547051031) \$35

- EXEMPT ORGANIZATIONS Disaster Relief by Employer- Controlled Charities; Letter to Steven T. Miller Regarding Proposal for Safe Harbor Guideline for Section 501(c)(3) Organizations Serving as General Partners of Tax Credit Limited Partnerships; Low Income Housing Organizations—Qualifying for 501(c)(3) Status (PC 547051032) \$25 |
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POINT & COUNTERPOINT

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avoided by implementing the 12-month rule. (Theoretical economists can address the fact that the compliance costs are real costs to the economy, while the revenue loss relates to a mere transfer payment.)

While we agree that computer-aided accounting greatly reduces compliance costs, the taxpayer's evaluation that must be made to account properly for an item at the front end is more complex than merely determining whether some benefit will remain at the end of the year. One must also determine the life of the item and how much will remain. On the other hand, many taxpayers may have already expended this effort for financial accounting purposes, and they may in fact do further work to change that treatment for tax purposes.

But the key point here is not really the cost to taxpayers of complying; it is the cost to the taxpayer and the Service

of auditing these items. To find these items, agents must pore over many records of expenditures properly accounted for. Taxpayers fight long and hard and often win, with no gain for the revenue.

Even if the Service effortlessly and consistently prevailed in these contests, however, there is also a significant opportunity cost. By their nature, these are at best small victories. (The same math applies: The fisc really gains only two percent of the amount shown as an adjustment in the Revenue Agent's Report.) The government is clearly trying to shift the focus of its agents to much more pressing (and lucrative) issues, such as contingent liability shelters and off-shore credit card accounts.

This is the bottom line. While Professor Johnson sees foxes in the hen house, we believe the question is whether every cop should be enforcing the 55 mph

speed limit during a widespread crime wave. The government should be applauded for a low-cost simplifying rule that will reduce taxpayer burden and shift the Service's limited resources to the issues that really matter.

REPLY FROM
PROFESSOR JOHNSON

We all agree that a 15 mph school zone speed limit needs to be administered with some unwritten discretion, so that the parent going through at 17 mph will not be hauled off to jail. But the abuses blessed by the proposals are like running the zone at 110 mph, and moreover claiming that speed as a matter of right. ■



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