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Two-thousand-four MAY meeting

PRIVILEGE AND WORK PRODUCT IN TAX CASES
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FROM THE **CHAIR**

by Richard A. Shaw, San Diego, CA

RICHARD A. SHAW

Much is happening as the Tax Section progresses through the winter season.

TAX SHELTERS

Closing down abusive tax shelters continues to be a high priority of the Federal Government. Congress still intends to deal with the issue of "economic substance" and increased penalties related to abusive tax shelters. Although legislation has been deferred, there is potential for new tax laws with the coming year.

On the administrative side, the Section Officers have had four meetings with the Service and Treasury on tax shelter issues this fall. At the meeting of Section Officers with Commissioner Everson on October 9, 2003, we strongly recommended that the Service and Treasury put Circular 230 back on the table and issue revised standards for attorneys drafting tax opinions. A proposed revision has, in fact, been released just before the end of 2003.

An important new undertaking is the effort of congressional leaders and Treasury to promote enhanced self-regulation among the tax professions.

On November 18 and 20, 2003, the Senate Committee on Governmental Affairs released a report, "U.S. Tax Shelter Industry: The Role of Accountants, Lawyers and Financial Professionals." The report challenges the ABA, along with the AICPA and the American Bankers Association, to establish standards of conduct to prevent members from aiding or abetting tax evasion, promoting abusive tax shelters, or engaging in related unethical or illegal conduct. Among the strongest recommendations is a proposal to prohibit the issuance of opinion letters on any tax product when the independence offered is compromised by legal design, sales, or implementation assistance related to the product, or by having any other financial stake in the product.

At our Fall Council Meeting on November 15 in Yulee, Florida, Pamela Olson, (Assistant Secretary of the Treasury (Tax Policy)), Mark Matthews (IRS Deputy Commissioner for Services and Enforcement), and John Klotsche (Senior Advisor to the Commissioner on Tax Shelters) presented a panel emphasizing the need for self-regulation by the ABA to deal with this issue.

At this meeting, and at a subsequent meeting with Treasury officials in Washington on December 8, Secretary Olson explained to Section leaders the difficulty that the government has in enforcing Code provisions because of the lack of economic resources and personnel. Although civil and criminal actions have increased, she believes this is an incomplete solution. Treasury believes that the ABA and AICPA must actively assist in the attack on the abusive tax shelter problem. It is the aim of Treasury to have tax professionals promote higher internal "best practice standards." In essence, Treasury is seeking to have the ABA Tax Section, along with other tax practitioner groups, develop a self-regulatory tax industry organization to which a tax professional could aspire to belong and maintain a high ethical standard of practice. Treasury has indicated that any such organization must have "teeth" and good internal housekeeping. We explained to Treasury that any such aspirational standards would create numerous difficulties with investigation, evidentiary discovery, objectivity and enforceability. Treasury has already held meetings with the AICPA and would like the ABA to engage in mutual discussions with the AICPA on the subject.

I bring this to your attention, since it is an obvious part of the current efforts of the Administration and Congress to seek greater self-regulation within our tax profession. I have no present vision where it will head, but we have indicated that we will look seriously into this very complex and idealistic subject.

On a more immediate level, the Tax Section plans to examine issues that can be addressed within the ABA itself.

ABA Formal Opinion 346 (revised as of January 29, 1982) has been the longstanding internal guideline establishing professional standards for the preparation of tax law opinions on tax shelters. I contemplate that the Tax Section will initiate a review of Opinion 346 to evaluate to what extent it should be updated and submitted to the ABA for formal adoption. Likewise, the Committee on Standards of Tax Practice has proposed some additional guidelines for drafting formal tax opinions. The Committee has been requested to reexamine those guidelines and present a proposal to the Council for its consideration.

The Section is also bringing the issue of professional ethics to the forefront by presenting an audience participation panel on non-tax shelter issues under Circular 230 at our Midyear Meeting in Florida. Now that the Service has come out with new tax

shelter Circular 230 guidelines this winter, the Section will want to consider those as well.

IRS OVERSIGHT BOARD

The Tax Section presented testimony at hearings before the IRS Oversight Board on January 26, 2004, on the development of the next five-year strategic plan for the Service. We have consistently expressed the need for the Service to receive appropriate funding and personnel to carry out the administration of the tax system.

SECTION BYLAWS

Revised bylaws for the Tax Section were approved at the Fall Council Meeting. Primarily, changes were made to modernize the bylaws to ensure that there is adequate flexibility to meet present structural needs and to plan future Section meetings.

The most significant amendment provides that Tax Section delegates to the ABA House of Delegates will be nominated by Council, rather than under the Section nominating committee process. By tradition, delegates have been selected from former chairs of the Section fully familiar with the structure and operation of the business of the Section. As representatives of this Section, they take advice from and report directly to Council at each regular meeting. The revised bylaws will be presented for consideration at a plenary session of the Section.

ABA GOVERNANCE

I have reported earlier that the ABA is undertaking a decennial review of governance. I am pleased to report that Irwin Treiger and Tom Jorgensen have been appointed to serve on a Section Officers Conference Committee that will work with the Board of Governors in strengthening the relationship of the Sections with the ABA.

SECTION COMMUNICATIONS

Vice Chair Celia Roady scheduled a conference in Washington, D.C., on January 9, 2004, with key leaders of the Section and the ABA to formulate a new three-year strategic communications plan for the Section. The present plan has been completed and was a resounding success. It is time to explore opportunities for the future.

One project just completed was a series of seven radio interviews with California and regional radio stations on tax benefits available to victims of the California Wild Fires that destroyed 3600 homes over 750,000 acres in Southern California. These interviews have enhanced the image of the Tax Section as a primary source of tax information for the public concerning emergency disaster relief provisions intended to reduce the burdens of the tax laws.

SECTION TASK FORCES

Good progress is being made on the special projects that several of the Section Task Forces have undertaken. A project to recommend international tax reform chaired by Stephen Shay and Leonard Schneidman is substantially completed and will present comprehensive recommendations this spring.

The Task Force on Joint Simplification with the AICPA and TEI, chaired by David Glickman and Terry Hyde, continues to strike forward on Code simplification and also is directing its attention to simplification of numerous highly complex regulations.

The Task Force on Pass-Through Entity Integration chaired by Jerry August is off the ground, and its 25 practicing lawyers and academics are meeting with the professional staff of Congress and the Administration at the Midyear Meeting in Kissimmee. It should be a lively discussion. ■

THE SECTION WANTS YOUR E-MAIL

Do you want to be alerted to important ABA and Section information by e-mail? If you have not registered your e-mail address with the ABA, or if you have an e-mail address change, please submit this information using the **Change of Address** form on the ABA website at **www.abanet.org/members/join/coa2.html**, or contact the ABA Service Center at 800/285-2221. Using the Change of Address form on the website, you can also request to be removed from ABA e-mail distribution lists. Please note that your e-mail address will be used only within the ABA—the ABA does not sell or rent e-mail addresses to anyone outside of the ABA (see the ABA privacy statement on our website). If you have any questions, please feel free to contact the ABA Service Center at the number above or the Tax Section office at 202/662-8670.

COUNCIL **ACTIONS**

by Evelyn Brody, Secretary, Chicago, IL

COUNCIL FILLS SECRETARY AND ASSISTANT SECRETARY VACANCIES

On October 30, 2003, the Council of the ABA Section of Taxation met by teleconference at 3:00 p.m. EDT for the purpose of filling unexpired terms in the offices of Secretary and Assistant Secretary. Dick Shaw, Chair of the Section, announced that Shannon Nash, the current Secretary, had recently resigned her office. Pursuant to Section 4.7 of the Bylaws, the Council is permitted to fill certain officer vacancies created by resignation. The Council then considered a list of potential candidates and, after discussion, elected current Assistant Secretary Evelyn Brody as Secretary and elected Christine Agnew (Chair of the Young Lawyers Forum) as Assistant Secretary, both for the terms ending July 2004.

PUBLIC POLICY UPDATE

The Tax Section sent comments to Treasury concerning "Tax Consequences Upon the Exercise of a Partnership Option or Conversion of a Debt or Preferred Interest in a Partnership," and to the White House regarding "Timely Reappointment of Judges to the Tax Court." These Comments can be viewed on the Section's website at www.abanet.org/tax.

FALL **COUNCIL MEETING**

The Council met on November 14-15, 2003, for the Fall Meeting at White Oak, Yulee, Florida. The Council heard reports and took action on the following items.

JOINT FALL MEETING WITH RPPT

Dick Shaw reported on the success of the Fall Meeting, held jointly with the Real Property, Probate, and Trust Law Section in Chicago.

SECTION LEADERSHIP APPOINTMENTS

Dick Shaw announced the following Section appointments: Christine Agnew, as Liaison to the ABA Commission on Women in the Profession; Loretta C. Argrett, as Liaison to the ABA Section on Dispute Resolution; Ian Comisky, as member of the ABA Commission on Sentencing Guidelines; Dick Shaw, as Liaison to Legal Assistance to Military Personnel and member of the ABA Committee on Section Business; and Irwin L. Trieger, as SOC Liaison to the ABA Governance Committee.

MENTORING PROGRAM

Council Director Jerry August, Chair of the new mentoring program, reported that the Young Lawyers Forum identified eight Tax Section members seeking a mentor to help them get involved with the Section. Several Council members volunteered.

PRO BONO AWARD

The Council adopted the selection criteria for the Section's Pro Bono Award proposed by the Pro Bono Committee, chaired by Past Section Chair Dick Lipton.

NOLAN FELLOWS GUIDELINES

The Council adopted revisions to the Nolan Fellows Guidelines regarding waiver of fees and reimbursement of expenses.

TASK FORCE UPDATES

The Council heard reports on the activities of several task forces: Business Activities Nexus, Tax Shelters, Simplification, Pass-Through Entity Integration, Individual AMT, Judicial Deference, International Tax Reform, and Federal Transfer Taxes. The Task Force on Guidance has been terminated, and its responsibilities assumed by the Government Relations Committee.

ABA **HOUSE OF DELEGATES**

Paul Sax and Stef Tucker, Section Delegates to the ABA House of Delegates, reported that, at the next meeting, the Tax Section Delegates will raise the Section's proposal to amend Code section 1361(e)(2), defining "potential current beneficiary."

TRAVELING **CLE**

The Council approved a proposal by Bob McKenzie, Vice-Chair (Professional Services), and by Council Director Elinore Richardson for a new CLE program to reach members at cities not usually the site of Section meetings.

PUBLIC SERVICE: **TAX TIPS 4U**

Celia Roady, Vice-Chair (Communications) briefed the Council on the Section's new and innovative public service website, *TaxTips4U*. This page is designed to provide helpful, current information to consumers seeking a better understanding of their rights and responsibilities as taxpayers. Visit www.TaxTips4U.org.

TAX SHELTER ENFORCEMENT ACTIVITY

A government panel described the status of tax shelter legislative proposals, enforcement strategy, and issues to be considered in the soon-to-be issued revisions to Circular 230.

IRS **BUSINESS PLAN**

Because the IRS Business Plan is now issued quarterly rather than annually, Mike Hirshfeld, Vice-Chair (Committee Operations) is reminding Committees to provide suggestions for priority on a quarterly basis. ■

POINTS TO **REMEMBER**

Editor's Note: The three POINTS TO **REMEMBER** in this issue cover a range of timely subjects. First, Don Bly gives us the latest word on the continuing saga of plaintiffs who face the issue of whether they recognize income when they receive damages, a portion of which must be paid to their lawyer as a result of a contingency fee agreement. The Sixth Circuit has broken ranks with its fellows, but Don still thinks the issue is deserving of Congressional resolution. Next, Kathleen Stephenson and Ed Kessel educate us on the usefulness of self-canceling installment notes and tell us how to structure them correctly. Finally, Carolyn Lee gives us a window on the new federalism wrought by the imminent disappearance of the credit for state death taxes. Her piece alerts us to a world of hitherto unknown pitfalls and planning opportunities.

BACK TO THE ORCHARD: THE SIXTH CIRCUIT EXAMINES CONTINGENT ATTORNEY'S FEES

by Donald R. Bly, Atlanta, GA

THE VIGNETTE

Congratulations! That tort lawsuit against your former employer has finally settled to the tune of $1 million. Of course, you will only see $600,000 of that amount, the balance going straight to your attorney; no complaint there, she deserves every penny of it. And you seem to remember that the proceeds from a tort lawsuit are now taxable. But at today's rates, not a problem—net-net, you will still collect around $300,000.

Mail time! Here's the check and—wait, you also got a 1099 that says you were paid $1 million. Why didn't your former employer deduct the portion that was paid directly to your attorney? No problem. If they won't deduct it, you will. Just plug that into your tax software, press this button and—hey, where did your deduction go? Where did all your money go?

THE PROBLEM

You likely have heard the recent fuss surrounding the issue confronting our hypothetical plaintiff: whether the portion of a settlement or judgment that represents contingent attorney's fees constitutes gross income to the plaintiff-taxpayer. Perhaps inspired by the lively debate on this topic in this publication (see the Fall 2000 *Newsletter* at p. 13), several federal circuits have addressed the issue in the last five years, each forced to walk an unmarked path through the Code and case law to decide an issue that, frankly, is best addressed by Congress.

But why has this emerged as a problem only recently? Weren't contingency arrangements around in the 20th century? Yes, but until 1997, when the section was amended to exclude only compensatory damages from tort suits involving a physical injury, section 104 excluded the proceeds from most other tort suits. Thus, the issue was rarely litigated. Now, however, the issue has some "juice." Compensatory damages from non-physical personal injuries (torts) are now included in gross income, as are all punitive damages.

Contrary to what we may have learned in our introductory tax courses, inclusion plus deduction does not equal exclusion. Because of the section 67 two percent floor, the alternative minimum tax, and the phase-out of itemized deductions, a taxpayer who collects a considerable, and taxable, settlement or judgment soon discovers that the ability to deduct fees paid to an attorney can be severely limited or completely disallowed. For many of these plaintiff-taxpayers, the inability to exclude from income amounts paid to their attorneys can mean a three-fold decrease, or more, in net proceeds because of the resulting tax liability.

Tax attorneys advising defendants in these suits also are faced with this issue. New regulations under section 6041 require a payor to report on Form 1099 "the amount includible in the gross amount of the payee (which in many cases will be the gross amount of the payment before fees, commissions, expenses or other amounts owed by the payee to another person have been deducted)." *See* Treas. Reg. § 1.6041–1(f). Thus, it is impossible to comply with these reporting rules without an understanding of the current state of law.

THE CASE LAW

The taxpayer that started this mess was Ms. Cotnam, who successfully litigated a $120,000 claim against the estate of her intestate employer, approximately $50,000 of which went to her attorneys. Much of the Fifth Circuit's opinion in *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959), is devoted to the issue of whether the net recovery was taxable income (it was), but the opinion also addresses the Service's follow-on argument: that the amounts paid to her attorneys also were includable in gross income. Here the majority opinion is brief. As background, Alabama, like many other states, has an "equitable lien" statute, which provides attorneys with property-like rights in the judgments payable to their clients. The court found that Alabama's equitable lien statute prevented Ms. Cotnam from ever having a claim over this $50,000, and concluded that under the "facts in this unusual case, taken with the Alabama statute, put the taxpayer in a position where she did not realize income as to her attorney's interests" (*Id*. at 125).

Although *Cotnam* generally is regarded as the forerunner of the current line of authority, the modern-day

debate is best gleaned not from the conclusory majority opinion, but rather from the dissenting and concurring opinions. In his dissent, Judge Wisdom argued that the "anticipatory assignment of income" cases (e.g., *Lucas v. Earl*, 281 U.S. 111 (1930), *Helvering v. Horst*, 311 U.S. 122 (1940)) governed here, because the income already had been earned by Ms. Cotnam by the time the attorneys were paid. In their concurring opinion, Judges Rives and Brown countered this dissent, arguing that the anticipatory assignment of income cases were irrelevant because the value of the taxpayer's claim was "doubtful and uncertain" at the time she assigned the contingency right to her attorneys prior to the lawsuit. Borrowing the arboreal metaphor first used in *Lucas v. Earl*, the concurring judges saw the contingency arrangement not as Ms. Cotnam's attempt to transfer the "fruit of her tree," but rather as the transfer of a part interest in her "barren tree" to her attorneys.

Though the concurring judges won the battle, the dissent won the war. With few exceptions, recent courts have, in the absence of an Alabama-type equitable lien statute in the state of venue, applied the anticipatory assignment of income doctrine. The primary exception is the Sixth Circuit, and in *Banks v. Commissioner*, 345 F.3d 373 (6th Cir. 2003), the exception formed a new rule.

THE SIXTH CIRCUIT'S DECISION

In an odd twist, the state of venue in *Banks* was not one of the Sixth Circuit's states of jurisdiction, but California. At issue was a tort suit that Mr. Banks had settled with the California Department of Education in 1990. The settlement amount was approximately $450,000, with $150,000 of that amount paid directly to his attorneys. At trial, the Tax Court found that, based on *Estate of Clarks v. U.S.*, 202 F.3d 854 (6th Cir. 2000), the amount paid to Mr. Banks' attorneys must be included in his gross income. Although the Sixth Circuit ultimately disagreed with the Tax Court's interpretation of *Estate of Clarks*, it is easy to understand the Tax Court's decision. In *Estate of Clarks*, the Sixth Circuit simultaneously dismissed the notion that this issue should depend on the intricacies of state property law and favorably compared the Michigan equitable lien statute at issue to the Alabama statute. When confronted with California's equitable lien statute, which does not provide attorneys with Alabama-type property rights in settlement or judgment proceeds, the Tax Court was forced to decide whether *Estate of Clarks* was based primarily on the Michigan equitable lien statute, or whether it stood for the proposition that a contingency fee is under no circumstances included in the plaintiff's gross income, at least in the Sixth Circuit. The Tax Court chose the former. According to the Sixth Circuit, it chose wrong; in the Sixth Circuit, contingent attorney's fees are excluded from the plaintiff-taxpayer's gross income.

While the Sixth Circuit devotes most of its opinion convincing itself that it is simply following *Estate of Clarks*, the better view is that *Banks* takes an entirely new step. With *Banks*, the Sixth Circuit becomes the first to reject completely the applicability of the assignment of income doctrine to contingency arrangements. Though true that, as the court points out, the Fifth Circuit has also refused to examine the underlying state equitable lien law in another case, *Srivastava v. Commissioner*, 220 F.3d 353 (5th Cir. 2000), the court in *Srivastava* was divided, and the majority opinion is based on a feeling of duty to follow *Cotnam*. As the Fifth Circuit lamented:

> Were we ruling on a *tabula rasa*, we might be inclined to include contingent fees in gross income. Principles of tax neutrality, if nothing else, dictate that result, for when a taxpayer recovers from a favorable judgment or litigation settlement, and compensates his attorney on a *non-contingent* basis, the full amount of the recovery may be treated as gross income (as petitioners acknowledged during oral argument). There is no apparent reason to treat *contingent* fees differently or to believe that Congress intended to subsidize contingent fee agreements in such a fashion.
>
> In *Cotnam*, however, this court excluded contingent fees governed by Alabama law from the client's gross income. Because *Cotnam* is substantially indistinguishable from this case, we reverse the Tax Court....

(*Id*. at 357–358.) The *Banks* court also cited the Eleventh Circuit as in its corner, though the Eleventh has only addressed cases involving Alabama law, where it is required to follow *Cotnam* as binding precedent in its circuit (the Eleventh split from the Fifth Circuit after the *Cotnam* decision).

Despite its best efforts to find comfort in numbers, the Sixth Circuit has set itself apart in *Banks*. The Fifth and Eleventh Circuits are less-than-zealous advocates for the rejection of the assignment of income doctrine; every other circuit that has addressed the issue (the Third, Fourth, Seventh, Ninth, Tenth, and Federal) has applied the doctrine. In a footnote highlighting the "split" in the circuits, the Sixth Circuit appears to invite our highest court's review. Even if Supreme Court review were likely—and it is not, since the Court has denied *certiorari* on this issue twice in the last five years—this is an issue that should be resolved not by the judiciary, but by Congress. With apologies to the Sixth Circuit, no one should believe that, under fair and neutral tax principles, the section 61 definition allows anything less than the entire amount of the settlement or verdict to be included in "gross income." It is only because of the sting that follows from the limitations imposed by Congress on individuals' deductions that some courts have danced around the obvious. Given the recent quality of this dance, it is Congress's turn to cut in.

THE LATEST WORD ON **SELF-CANCELLING INSTALLMENT NOTES***

by Kathleen Stephenson and Edward Kessel, Philadelphia, PA

Estate of Costanza v. Commissioner, 320 F.3d 595 (6th Cir. 2003), *rev'g and remanding* T.C. Memo 2001–128, blesses the use of a self-cancelling installment note (SCIN) as a valid estate planning tool. The Sixth Circuit opinion accepts a planning technique approved in *Estate of Moss v. Commissioner*, 74 T.C. 1239 (1980), but it leaves the valuation of the note as an open issue. The opinion also fails to discuss the recognition of gain issues raised in an earlier decision, *Estate of Frane v. Commissioner*, 998 F.2d 567 (8th Cir. 1993), *rev'g* 98 T.C. 341 (1992).

BACKGROUND

Because it involves a series of payments, a SCIN has some of the characteristics of an annuity and some of the characteristics of an installment sale. If an annuity provides for payments so long as the seller lives, the seller may ultimately receive substantially more than the value of the property transferred. A SCIN, on the other hand, terminates on the earlier of the seller's death or payment in full. Because the seller may die before receiving payments equal to the property's value, the Service may assert that the SCIN is not full and adequate consideration for the property being transferred, thus triggering adverse tax consequences for the seller or the seller's estate. For the SCIN to constitute full and adequate consideration, the payment terms must reflect not only the value of the property transferred but also a premium. The premium compensates for the risk that a premature death may result in the seller receiving less than the value of the property transferred. The premium can be reflected in a higher interest rate (SCIN–INT) or a higher purchase price (SCIN–PRIN).

For federal estate tax purposes annuities are taxable under section 2039, which includes in the gross estate the value of any annuity or other payment receivable by any beneficiary by reason of surviving the decedent, under any form of contract or agreement. Annuities must be valued using the Service's tables. See *Estate of Cullison v. Commissioner*, T.C. Memo 1998–216, which involved the sale of farmland for a private annuity. The estate valued the annuity by reference to market interest rates for real estate. The Tax Court held that section 7520 controlled and that therefore the federal tables for annuities must be used.

For the SCIN to avoid a Service challenge that it is an annuity, its terms should be structured so that full payment of the note is anticipated to occur within the holder's actuarial lifetime. If the life expectancy of the holder is less than the timeframe set for the final installment, the Service will treat the installments cancelled at death as an amount taxable under section 2039. *See* GCM 39503 (June 19, 1986).

But, does this mean that section 7520 must be used in valuing the SCIN, bringing into play the presumptions in the regulations defining "terminal illness?" GCM 39503 (May 7, 1986), in discussing whether a SCIN should be taxed under section 72 (annuities) or section 453 (installment sales), states that the monetary limit tends to dilute the annuity nature of the transaction. Therefore, the income tax treatment will depend upon whether or not the stated maximum payout will be achieved in a period less than the life expectancy of the transferor. The GCM goes on to say (citing S. Banoff and M. Hartz, *Sales of Property: Will Self-Cancelling Installment Notes Make Private Annuities Obsolete?*, 59 TAXES 499 (1981), and E. Schnee, *Cancelling a Debt Correctly Can Give Rise to Estate and Gift Tax Advantages*, 8 EST. PLAN. 276 (1981)) that in analyzing an installment sale there is no requirement that the actuarial tables be used to determine if the transaction included a gift element, and the taxpayer's particular health status may be considered.

MOSS AND *FRANE*

In *Estate of Moss*, the decedent sold his stock in a funeral home for a note (SCIN) calling for monthly payments of principal and income for a set term. The note also provided for the cancellation of the remaining payments should he fail to survive the term. Although he was not in poor health when he entered into the transaction, the decedent failed to survive the term. The Service argued that the transaction was equivalent to one of two situations: (1) the decedent retained control of the debt until death and then forgave it by will; or (2) the decedent made an assignment of the note to be effective on his death. The Tax Court disagreed and held that the SCIN did not represent anything of value to the decedent at death. It rejected the Service's argument that the note was includible under section 2033. *Estate of Moss* thus made the SCIN a legitimate estate-planning vehicle.

The parties in *Estate of Moss* had stipulated that the decedent's sale of stock was a bona fide sale for adequate and full consideration. As a result, the taxpayer avoided the adverse gift and estate tax consequences that arise if the SCIN does not constitute full and adequate value for the property transferred. If the value of the property transferred exceeds the value of the SCIN on the date of the transfer, the excess amount will constitute a gift under section 2512. Unless the holder of the note survives the term, the SCIN may also be subject to tax as an annuity under section 2039 or as a transfer taking effect at death under section 2037. If the estate tax applies, the value of the property at the date of death, rather than the value at the date of gift, may control.

An additional question is the identity of the appropriate taxpayer for

* For an excellent, and more detailed explanation of SCINs, readers should refer to S. Banoff, M. Hartz and V. Famparska, *Appellate Court Upholds SCIN as Bona Fide Sale: Planning Opportunities Enhanced*, 98 J. TAX'N 292 (2003).

income recognized as a result of death before the end of the SCIN term. In *Estate of Frane*, the Tax Court held that the decedent's final tax return should report income equal to the excess of the face value of the SCIN over the basis of the property that had yet to be fully recovered. The Eighth Circuit reversed and taxed the income to the decedent's estate. The Tax Court finding is the more favorable for taxpayers, as it would produce an estate tax deduction under section 2053 and would also allow an offset for passive activity losses on the final income tax return.

COSTANZA

In *Estate of Costanza*, the decedent sold his interest in a restaurant and commercial real estate to his son in exchange for a SCIN. The SCIN provided for monthly installments over an eleven-year period and included a cancellation on death provision. The son made the first three monthly payments by backdated checks and made no further payments during the decedent's lifetime. The decedent died five months after the SCIN was issued.

The SCIN provided for an initial interest rate of 6.25%, increasing in stages, every two years, until it reached 8.75% for the final 12 months of the term. In January 1993, the first month of the SCIN, the Applicable Federal Rate was 7.63%. The Tax Court decision does not specifically indicate whether this SCIN involved an interest-rate or purchase price premium.

The Tax Court held that the SCIN was not a bona fide transaction and should be treated as a taxable gift. The Sixth Circuit disagreed, ruling that the estate provided satisfactory explanations for the backdated checks and the failure to make the final two payments. The Sixth Circuit also ruled that the testimony of medical experts that the decedent had a five to 13½ year life expectancy was sufficient to show that, at the time the transaction was entered into, the decedent had a real expectation of repayment. GCM 39503 would impose a gift tax unless the value of the property transferred is equal to or less than the value of the obligation, considering the taxpayer's particular health status. The testimony regarding the five to 13½ year life expectancy would not appear to be sufficiently precise to meet the exception, and was not, in fact, mentioned in the Tax Court opinion.

Although it ruled in the taxpayer's favor regarding the bona fide transaction issue, the Sixth Circuit remanded the case to the Tax Court for consideration of the government's alternative argument, that the transaction was a bargain sale subject to gift tax.

CONCLUSION

In summary, a SCIN may be a feasible estate-planning tool, but it must be used carefully!

THE RISING SIGNIFICANCE OF **STATE DEATH TAXES**

by Carolyn Joy Lee, New York, NY

The 2001 federal legislation "repealing" the estate tax included, as a revenue-raising feature for the federal fisc, the phased-out repeal of the federal credit for state death taxes. Section 2011(c) had provided a sliding-scale credit against federal estate tax for "the amount of any estate, inheritance, legacy or succession taxes actually paid to any state or the District of Columbia, in respect of any property included in the gross estate," with the maximum credit equal to 16% for adjusted taxable estates of $10,040,000 and higher. That credit is now being phased out in 25 % increments over 2002-2004, and in 2005 will be replaced with a federal deduction for state death taxes. For decedents dying after 2004, therefore, there is no federal credit, only a deduction against the ultimately-to-be-phased-out federal tax. I.R.C. § 2011(g).

Prior to the 2001 federal legislation, virtually every state had some form of death tax designed to maximize the utility of the federal credit. This uniformity in the state tax treatment of death taxes was the product of an historically significant compromise, brokered in the 1920s, through which the federal government and the states arrived at a mutually agreeable allocation of death tax revenues. Specifically, the federal credit for death taxes represented, at its enactment, a solution to federal-state wrangling over death tax monies that began in the nineteenth century. The federal credit was a compromise that recognized the encroachment of the federal government on traditional sources of state revenues, and sought to compensate the states, in some comprehensive and efficient manner, for the federal incursion. It was conceived, not as a federal stipend to the states, but as a form of revenue sharing, and had the salutary effect of eliminating state-to-state competition in death tax regimes, and of making state death taxes all but invisible to taxpayers and tax planners. (This early history of death taxes in America is recounted in a fascinating article by Eugene E. Oakes, a professor of economics at Yale at the time of its publication, *Development of American Death Taxes*, 26 IOWA L. REV. 451 (1941).)

With the repeal of the federal credit, however, a variety of new state death tax patterns have emerged. In some states, such as Connecticut, the state estate tax was pegged by statute to the amount of the federal death tax credit. In such states, the federal legislation had the immediate effect of reducing the state tax rate (and taking those additional monies in as federal estate tax revenues). Other states, such as New York, had an estate tax that was drafted to match the federal credit but was not directly derivative of the federal Code. In New York the federal legislation did not affect the amount of the state estate tax, meaning that New York decedents continue to pay the same state tax as before, but get a smaller credit against their federal taxes. Indeed, after the "repeal" of the federal estate tax, the total estate tax rate for New York taxpayers can be as high as 60 %. And some states, such as Florida, are constitutionally prohibited

from imposing any state death tax in excess of that allowable as a federal credit. In Florida, therefore, the repeal of the federal credit mandated a reduction in state revenues that can only be undone by a (highly unlikely) constitutional amendment.

Even without state action, the federal legislation effected immediate state-to-state differences in the application and cost of death taxes. An early estimate by the Center on Budget and Policy Priorities projected that a full repeal of the federal credit, based on fiscal 2000 numbers, would represent an annual loss to the states of approximately $5.5 billion. Given the significant amounts of state tax revenues in play it was inevitable that states would respond with their own legislative initiatives, and inevitably would respond in differing ways. We are now inheriting that wind.

New Jersey, for example, enacted legislation effective July 1, 2002, to "freeze" its estate tax at the amount of the maximum federal credit as of December 31, 2001 (i.e., before the phase-out began), and also to cap the exclusion at $675,000, rather than following the federal increases in the exemption amount. Jurisdictions as varied as The District of Columbia, Maryland, Massachusetts, Minnesota, Nebraska, North Carolina, and Wisconsin have decoupled their death taxes from an automatic phase-out that would follow repeal of the federal credit, and legislation is pending in numerous other states to do likewise. For those keeping count, more than a dozen states have enacted various forms of decoupling legislation since the federal "repeal," preserving in various forms their own death taxes notwithstanding that this means their domiciliaries will pay more death taxes than those of neighboring states, or of course those in sunny Florida.

What this means for tax advisors is that we must now be very sensitive to the states in which clients are domiciled (and to states which may lay claim to domicile), and also to the states in which their assets are located. The Florida domiciliary who owns a summer home in New York may pay state estate tax (to New York); the one owning the home in Connecticut may not (because neither Florida nor Connecticut, which pegged its state tax to the federal estate tax credit, will have such a tax in the absence of the federal tax credit). Consideration also should be given to the form in which assets are held. A decedent dying with ownership interests in an LLC may present a significantly different state estate tax picture than the decedent owning assets outright.

In the real world, of course, clients do not always report to their estate tax advisors every time they acquire or dispose of assets. The job of the estate planner, thus, is not solely to become familiar with the new patchwork of state death taxes, but also to sensitize clients to the nuances state death taxes now can present for both the locus and the form of investment.

Of potentially greater complexity are the state tax issues that will arise should federal "carryover basis" ever come to pass. New section 1022 provides for carryover basis effective 2010 (but would allow certain additions to the decedent's federal basis, including a $1.3 million fixed step-up, a step-up for spousal property, and a step-up for unused losses, which add even more planning intrigue). Fundamentally, carryover basis changes the tax consequence of death from an inheritance/transfer tax event to a potential income tax event. It changes, as well, the identity of the taxpayer, from the decedent (or his heirs) to the persons ultimately effecting a taxable disposition. And it changes the timing of the imposition of tax, from a tax imposed at the time of death to a tax imposed at the time of a taxable disposition. The federal rules also would provide some opportunity to target the limited allowance for basis increases to specific assets.

These changes in the nature of the tax imposed by reason of death can have profound state and local tax consequences. For example, Florida does not have a personal income tax. Prior to the federal legislation, Florida collected estate tax of as much as 16% of the value of Florida estates from decedents domiciled in Florida. If under the new regime Florida heirs inherit property with a carryover basis, they will pay no state income tax on the sale of such property (because Florida does not have a state income tax). By contrast, if the Florida decedent's property passes to heirs who are residents of New York City, the sale of such property with a carryover basis will produce, for New York, state and local income taxes of over 12% (at today's rates) of the excess of the property's value over its basis.

As this simple example shows, carryover basis will place a premium on planning techniques that take advantage of the state-to-state differences in income tax regimes. Such planning may occur within the four corners of the will, as different assets are directed to different heirs, or may span years following death, as heirs seek to manage the timing and form of their dispositions to reduce state and local income taxes.

Overall, state taxes appear not to have been given much if any consideration in the course of the federal estate tax debate. As a result, we have now inherited a new world in which state taxes have become an essential part of estate planning, and the nationwide simplicity that once prevailed has been replaced by very different, and no doubt competing, state tax regimes.

Unfortunately, this balkanization of American taxes is not confined to the deathbed. The federal tax stimulus legislation enacted in the wake of September 11, 2001, included significant one-time "bonus" depreciation deductions for assets acquired post-September 10. States soon recognized that their faltering state budgets could not absorb such generous deductions; most particularly could not do so in March, 2002, effective retroactively to September of 2001. What followed, therefore, were a host of state laws decoupling state depreciation deductions from federal depreciation. These laws required taxpayers with business assets to maintain two (or more, when AMT is counted) sets of books over

SEE POINTS TO **REMEMBER**, PAGE 13

SPECIAL REPORT:
PRIVILEGE AND THE WORK PRODUCT DOCTRINE IN TAX CASES*

INTRODUCTION: On Thursday, March 25, 2004, from 1:00 – 2:00 p.m. EST, the Section together with ABA-CLE will sponsor another in its ***Tax Link Live*** Teleconference series. This special ethics teleconference will feature a discussion on ***"Privileges and Work Product in the Context of Tax Litigation: Lessons from the Trenches,"*** and will be led by Professor Martin J. McMahon, Jr. of the University of Florida College of Law and Steven S. Brown of Martin, Brown & Sullivan, Ltd., Chicago, IL, with Michael G. Yopp of Waller, Lansden, Dortch & Davis PLLC, Nashville, TN, serving as moderator. There will be ample opportunity for questions from those who are participating in the teleconference. For details on registering and obtaining CLE ethics credit, please see the box immediately following this report on page 13.

In this Special Report, Professor McMahon describes the current contours of the attorney-client and similar privileges as well as the work product doctrine and explains why they are at the forefront of current tax litigation. He also demonstrates why these developments have implications far beyond the tax shelter context in which some of the recent litigation has taken place and why these privileges and doctrines have to be considered at the time communications between tax advisors and clients are taking place and as documents are being drafted.

by Martin J. McMahon, Jr., Gainesville, FL

Over the past few years, the issue of the applicability of the attorney-client privilege, the related section 7525 tax practitioner-client privilege, and the work product doctrine have emerged as significant issues in tax litigation. For the most part, the recent cases have arisen in the context of marketed tax shelters and other aggressive tax planning transactions, but a few of the cases have arisen in more prosaic contexts. As a result of the recent firestorm of controversy in this area, tax practitioners are becoming increasingly conscious of the importance of raising privilege and work product doctrine claims when the Service seeks information about taxpayers' transactions pursuant to a summons or in the course of discovery.

The attorney-client privilege is a rule of evidence (and discovery) relating to a client's confidential communications to an attorney. (*See* Fed. R. Evid. 501; Fed. R. Civ. P. 26(b)(1) (both carving out privileged communications). In tax cases, privilege is governed by federal law. *E.g.*, *Johnston v. Commissioner*, 119 T.C. 27 (2002).) According to Wigmore's definition of the attorney-client privilege, "when *legal advice is sought*, from a professional legal adviser in that capacity, the *communications relating to that purpose, made in confidence, by the client*, are at his instance permanently protected, from the disclosure by himself or by the legal adviser, except the protection be waived." JOHN HENRY WIGMORE, 8 WIGMORE ON EVIDENCE § 2292 (McNaughton rev. 1961) (emphasis added). The attorney-client privilege exists for the purpose of encouraging full and truthful communication between an attorney and his client and "recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client." *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981). An attorney's advice to a client is privileged only to the extent that disclosure of that advice would disclose the client's confidential communications. *See, In American Standard, Inc. v. Pfizer Inc.*, 828 F.2d 734 (Fed. Cir. 1987). Significantly, the attorney-client privilege does *not* extend to communications between a taxpayer and an attorney relating to the preparation of a tax return. *See e.g., United States v. Frederick*, 182 F.3d 496, 502, *reh. denied* (7th Cir. 1999), *cert. denied*, 528 U.S. 1154 (2000), and cases cited therein.

If information is communicated to an attorney by someone other that the client or his agent, it is not generally privileged. *See, e.g., United States v. Threlkeld*, 241 F. Supp. 324, 326 (W.D. Tenn. 1965). However, under the *Kovel* doctrine, a client's communications to a third party, e.g., accountant, investment banker, etc., hired by the attorney, are privileged if the third party is necessary to interpret or translate the information for the attorney to enable the attorney to provide legal advice. *United States v. Kovel,* 296 F.2d 918 (2d Cir. 1961).

If the communications are disclosed to a third party, the privilege generally has been waived. *In re Sealed*, 676 F.2d 793 (D.C. Cir. 1982). In tax cases involving the assertion of penalties (e.g., section 6662 accuracy related penalties), raising reliance on the advice of an attorney as a defense to penalties results in a waiver of the attorney-client privilege. *Johnston v. Commissioner*, 119 T.C. 27 (2002) (civil fraud penalty). In some instances a waiver may be limited. In *Long-Term Capital Holdings v. United States*, 90 A.F.T.R.2d 2002–7446 (D. Conn. 2002), *on further proceedings*, 91 A.F.T.R.2d 2003–1139 (D. Conn. 2003), the taxpayer obtained a tax opinion from King & Spalding relating to certain aspects of a transaction.

* A few portions of this Article have been adapted from various CLE outlines prepared by the author and Professor Ira B. Shepard, University of Houston Law Center, over the past ten years.

Without specifically disclosing the opinion letter itself, the taxpayer revealed to its tax accountant that it had a "more likely than not" opinion with respect to the allowability of a deduction as a result of the transaction. The disclosure of the existence of the opinion, and that it was a "more likely than not" opinion with respect to allowance of deduction, disclosed the gist of opinion, and such disclosure was a waiver of those portions of the opinion letter reflecting the matter actually disclosed, but not of the entire subject matter.

There is no accountant-client privilege under federal common law. *Cavallaro v. United States*, 284 F.3d 236 (2002); *Couch v. United States*, 409 U.S. 322, 335 (1973). This rule has been modified by section 7525, which creates a limited privilege for non-attorney tax practitioners by extending the common law attorney-client privilege to "tax advice" for taxpayer communications with a "federally authorized tax practitioner." The section 7525 privilege does not apply, however, to tax advice regarding "corporate tax shelters." The section 7525 privilege may be asserted only in noncriminal tax matters before the Service and in noncriminal tax proceedings "brought by or against the United States" in federal court.

The identity of a client, or the fact that a given individual has become a client are matters that an attorney normally may not refuse to disclose. *See, e.g., Colton v. United States*, 306 F.2d 633(2d Cir. 1962), *cert. denied*, 371 U.S. 951 (1963). In a few instances, however, a client's identity may be privileged. In *Baird v. Koerner*, 270 F.2d 623, 632 (9th Cir. 1960), the Ninth Circuit allowed the attorney-client privilege to be claimed where the client's identity might have been "the link that could form the chain of testimony necessary to convict an individual of a federal crime." Client identity also was protected by the Seventh Circuit in *Tillotson v. Boughner*, 350 F.2d 663 (7th Cir. 1965), on the grounds that the government already knew so much about the transaction that revealing the client's identity would be tantamount to revealing the client's privileged communication to the attorney.

Client identity privilege has been asserted in several recent high profile cases involving tax shelters, but these claims have not been sustained. The most notable of these cases is *United States v. BDO Seidman*, 337 F.3d 802 (7th Cir. 2003), *motion to stay mandate denied* by 345 F.3d 465 (7th Cir. 2003), in which the Seventh Circuit affirmed a district court's determination that tax shelter investors failed to establish that a confidential communication would be disclosed if their identities were revealed. Disclosure of their identities would disclose to the Service only that they had participated in one of the tax shelters described in the summonses, but no confidential communication could be inferred from that information alone. The court distinguished *Tillotson* and similar cases, as situations in which "the Government already knew much about the substance of the communications between the attorney and his unidentified client," from the *BDO Seidman* case, where "the IRS knows relatively little about the interactions between BDO and [the investors], the nature of their relationship, or the substance of their conversations." Furthermore, in a sweeping conclusion, the court held that the tax shelter disclosure rules of section 6112 virtually preclude assertions of identity privilege by tax shelter investors.

Client identity privilege claims also were rejected in *Doe #1 v. Wachovia Corporation*, 268 F.Supp. 2d 627 (W.D. N.C. 2003). The Service served an administrative summons on Wachovia, which had marketed the tax shelter investments, seeking investor lists, documents, and other information relating to potentially abusive tax shelters pursuant to the regulations under section 6112. Investors intervened, arguing that disclosure of their names would disclose privileged information provided by them to KPMG (section 7525 privilege) and to Jenkens & Gilchrist (J & G) (attorney-client privilege), both of which had participated in designing the transactions or had provided opinions regarding the transactions. The court found that there was no attorney-client relationship between the investors and J & G. There was no evidence that any investor "ever had so much as a conversation with an attorney at J & G," there was nothing uniquely tied to the individual investors' financial situation, and the package contained no confidential information. In addition, the section 7525 privilege did not apply with respect to KPMG. First, the privilege only applies in cases by or against the government and before the Service, and *Wachovia* involved a suit by investors seeking an injunction against Wachovia, not a proceeding by or against the United States. Second, section 7525 provides that the privilege does not apply "to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter," which the court found precisely described the circumstances of the case – KPMG's communications were with Wachovia, a corporation. Finally, KPMG's advice was in the context of return preparation, which is not privileged.

The increasing number of instances in which attorney-client privilege and the section 7525 privilege have been asserted when the Service has sought to obtain communications from tax advisors to their clients and other related documents emphasizes the importance of understanding the scope of these doctrines not only at the controversy stage, but also at the planning stage, when these documents are being created. Both practitioners and their clients need to be aware of the extent to which potential communications are privileged. This is not necessarily as easy as it sounds because the parameters and scope of privilege in the context of tax planning are still being developed, as evidenced by the recent cases discussed above. It is very important to be as aware of the cases in which the claims have been rejected as it is to understand the cases in which they have been accepted. ■

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POINTS TO **REMEMBER**
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the life of the assets, in order to record properly the differing federal and state depreciation deductions, basis and ultimately gain or loss on assets that qualified for federal but not state bonus depreciation.

Even the federal rate changes have ramifications for state and local taxpayers. With the reduction in federal income tax rates to 15 % for dividends and even as little as 10 % for capital gains, and the increase in various state personal income tax rates to address budgetary shortfalls, increasing numbers of taxpayers are finding themselves caught up in the federal alternative minimum tax, under which deductions for their state and local income taxes are disallowed. This situation can put a premium on timing, whether of gains and losses or of tax payments, but the need for such planning is not as widely recognized as it should be.

Federalism is a wonderful concept. In the area of taxation, however, these instances of federal/state nonconformity show that it is a mixed blessing, and increasingly a source of inefficiencies and problems for both taxpayers and those who advise them. ■

POINT & HISTORICAL POINT: THE TAX PROTEST MOVEMENT: PAST, PRESENT, AND FUTURE

The tax protest movement in the United States is quite old, but unlike some of us mortals, it is neither infirm nor forgetful. Like Dick Clark on New Year's eve, it shows no signs of slowing and may well outlive us all. In August 2003, the movement arguably received a boost when Vernice Kuglin, a FedEx pilot who had tangled with the Service in Tax Court with respect to her 1994 and 1995 tax liability (*Kuglin v. Commissioner*, T.C. Memo 2002–51), was acquitted of six counts of tax evasion for the years 1996–2001 by a Tennessee jury. The jury found that Ms. Kuglin did not believe she had an obligation to pay taxes. Although Government officials have stated that the case does not mark a pro-protester change in the law, the outcome of the case nevertheless raises important issues both about the current state of the tax protest movement and about the impact of the movement on the collective will of the citizenry to fulfill its tax obligations.

This variation on the more typical Point/Counterpoint addresses those two issues. First, Richard Schmalbeck draws on his thorough analysis of the trial transcript and other court documents to explain how the *Kuglin* result came to be and to draw some lessons for the future of such litigation. Marjorie Kornhauser then puts anti-tax rhetoric and the tax protest movement itself in historical and political perspective, explaining its roots in the right of revolution and examining the functions that it can serve within the tax system. Together, these two scholars unconnected personally with either side of the controversy enhance our understanding not only of *Kuglin* but also of the role of tax protesters in the system and the challenges they pose. —*Ed.*

VERNICE KUGLIN AND VOLUNTARY COMPLIANCE: NOT THIS YEAR, THANKS

by Richard L. Schmalbeck, Durham, NC

My greatest fear in writing about the *Kuglin* case is that I may inadvertently give aid and comfort to the enemy. *Kuglin*, in which a taxpayer—or, more accurately, a non-taxpayer—was acquitted of tax evasion by a jury in the Western District of Tennessee in August 2003, was a major victory for the tax protester movement. Since that movement is famously selective in its choice of authorities, even an occasional victory of this magnitude is enough, one fears, to launch a thousand imitators. The last thing I want to do is to clarify the template for those imitators to follow, or to seem to offer approval of the outcome in *Kuglin* itself.

So, if the tax protesters in the room would excuse themselves? Thank you. For the rest of us, the facts: The non-taxpayer, Vernice Kuglin, was for a number of years (and probably still is) a pilot for Federal Express, and was based at their headquarters in Memphis, Tennessee. She is the daughter of missionaries, a single parent of slightly above-average education (three years of college) and significantly above-average income (ranging from $168,000 to $191,000 in the tax years involved in her case). About a decade ago, after an extensive study of the tax law, she concluded that she probably didn't have to pay federal income taxes if she chose not to. At a couple of points, she asked the Service whether it believed she was compelled to pay taxes, and, if so, by what authority. Telephone contacts with the Service were, to her mind, unhelpful; and as to her written queries, the Service behaved rather like God in an existentialist play, maintaining a stony silence in the face of her repeated entreaties.

In response, beginning in 1993, and continuing through 2001, Ms. Kuglin intentionally did not file income tax returns. She did file W–4 forms, for purposes of determining her wage withholding obligations, which claimed either ten personal exemptions (despite having only one dependent child), or total exemption from withholding on grounds that she was exempt from the income tax itself. Eventually, she was indicted for tax evasion for the years 1996 through 2001, inclusive. She was not prosecuted for the first three years for which she hadn't filed, presumably because those earlier years were, by the time the indictment was issued, closed by the statute of limitations. (This may have been significant, since it would seem to have been easier to prove knowing falsehood as to the claim for ten exemptions than for the claim of total exemption; but the former claim was only made in the earlier years.)

Her defense conceded many of the government's allegations, but denied that any shortcomings were willful. The key evidence was her own lengthy testimony, during which she recounted her passage from willing taxpaying to conscious refusal. The first step in her transformation was based on her reflections on the meaning of "voluntary compliance." As she put it: "[T]hey [antecedent unclear] said it was voluntary compliance. Now the words voluntary and compliance to me don't match very well. Voluntary . . . was something that wasn't mandatory . . . [but] compliance was completely different. It was something you had to do. So I was confused by this term." (Trial Record, vol. II, at 202.)

When her questions to the Service went unanswered, she studied the tax law herself. And she learned, at least by the time of her trial, quite a lot. Her testimony was a *tour de force* of contem-

porary tax protester arguments, including ones based on the Service's alleged failure to comply with provisions of the Privacy Act of 1974 and the Paperwork Reduction Act of 1980, and arguments to the effect that withholding is only required as to payments to nonresident aliens, among several others. But the central argument with respect to her determination that she did not owe any income tax was based on her close examination of several tax opinions, which she summarized as follows:

> From the Constitution, I learned that there were two forms of taxes, direct taxes and indirect taxes. . . . Pollock [157 U.S. 429, 158 U.S. 601 (1895), in the dissenting opinion of Justice White] identified income taxes as . . . indirect taxes. . . . Brushaber [240 U.S. 1 (1916)], . . . reconfirmed this. Flint versus Stone Tracy [220 U.S. 107 (1911)] had defined for me what an [indirect] tax was, and I realized that my occupation did not fall under the categories [subject to such taxes] of manufacturing, corporations or licenses. Jack Cole versus McFarland (*sic*) [*Jack Cole Co. v. MacFarland*, 206 Tenn. 694, 337 S.S. 2d 453 (Tenn. Sup. Ct. 1960)] was the clincher [; it said that] I had a right to earn a living . . . and that right cannot be taxed, and that really was the final . . . piece of the puzzle. . . .[Trial Record, vol. II, at 238.]

This argument, of course, as well as all the others she offered, is full of mistakes. She doesn't appear to understand, for example, what to make of statements contained in dissenting opinions, or in state tax law opinions. But while the arguments to the effect that she owed no tax were specious, the argument that she could have *believed* that she owed no tax was not. And, of course, in a tax evasion prosecution, her beliefs were critical. Throughout her testimony, Ms. Kuglin presented herself convincingly as someone who had made diligent efforts to determine her responsibilities, before concluding that they *probably* did not include paying income taxes. (The absence of certitude in her testimony seems to have enhanced its credibility; the sense of her presentation wasn't that she was sure that she was right, but rather that she truly thought she might be.) One is reminded in her testimony of a fundamental tenet of the Protestant Reformation: the notion of the priesthood of all believers. As slightly transformed to this context, the view of the defendant seemed to be that she should be able, if she put her mind to it, to form her own interpretations of the relevant legal materials; and that, furthermore, her interpretations were entitled to as much weight as any expert's (or any court's, for that matter).

One might have hoped that the cross-examination would have shaken some of Ms. Kuglin's representations about her state of mind. One suspects that much of her defense was manufactured for the trial, rather than having been formulated by the time she decided to cease compliance; closer attention to what she knew, and when she knew it, might have revealed more about her state of mind at the times of the alleged acts of evasion. But the cross was largely ineffective. The Assistant U.S. Attorney trying the case does not appear to have been a tax specialist, and generally seemed less familiar with the legal materials in question than the defendant herself, who occasionally offered gentle corrections on items like the dates of important tax cases. (*See, e.g.*, Trial Record, vol. III, at 86 (*Brushaber* decided in 1913, not 1896).)

The jury did not find this an easy case, reporting to the judge after about four hours of deliberations that the members of the jury did not think that they would be able to reach a verdict. But after further deliberation the following morning, the jury acquitted Ms. Kuglin. Sporadic quotes from jurors appeared in some press accounts, but not in sufficient detail to form a clear view of their collective evaluation of the evidence. But it would be quite wrong to think of this as an instance of jury nullification. The defendant's testimony was convincing enough to explain the outcome without resort to any untoward assumptions about the jury's predisposition.

As disturbing as the outcome of this case is, I think that there is reason to believe that it may be a bit less dangerous than it at first appears. The character and personal qualities of the defendant contributed greatly to her success; those will not be easily replicated by any large number of taxpayers. She managed to display high degrees of both intelligence and naivete, which made it possible for her to weave a narrative of her road to noncompliance with enough superficial coherence to convince the jury that a relatively unsophisticated person (as she appeared to be, despite her intelligence) might actually have believed it.

What are the lessons that the Service and Justice Department might learn from this case? Most are obvious, and I imagine ones that the Government has already noted. First, the phrase "voluntary compliance" should be forever banned from the lexicon of the taxing authorities. It clarifies nothing, and sows predictable confusion. Second, the Service should answer its mail, if only with a stock letter assuring protesters that they are indeed obligated to file returns and pay their taxes. Third, because the Government cannot afford to lose very many cases like this, the Justice Department should allocate ample resources from the criminal section of the Tax Division for these prosecutions. Finally, and most importantly, the Government should be more selective in deciding whom to prosecute for tax evasion; in particular, unless it is reasonably certain that it can show that the potential defendant could not plausibly have entertained doubt about her responsibilities to declare and pay taxes, it should move slowly, perhaps initiating civil actions to collect tax and penalties first, and pursuing criminal penalties only if resistance persists in tax years after ample notice to the taxpayer can be demonstrated.

Does this last suggestion amount to giving a taxpayer something of a "one free bite" rule as to tax compliance? Perhaps. But civil penalties can still present a significant deterrent. And an approach of the sort suggested simply responds to a reality that the Govern-

ment has to face: the tax protest movement is sufficiently well-established at this point that it is actually not implausible that taxpayers in some circumstances could, in some semblance of good faith, form the view that they owe no tax. Whether that was true in Ms. Kuglin's case or not, I do not know; but I can say that, on the basis of the record, a jury could, and apparently did, decide that it could not say beyond a reasonable doubt that she had violated a known legal duty.

ANTI-TAX RHETORIC – TINDERBOX OR SAFETY VALVE?

by Marjorie E. Kornhauser, New Orleans, LA

The power to tax, the Supreme Court once said, "is not only the power to destroy, but it is also the power to keep alive." *Nicol v. Ames*, 173 U.S. 509, 515 (1898). For over 100 years Americans have remembered and repeated the first half of the sentence and forgotten the second. This selective amnesia is especially striking since the point of the Court's pronouncement was to emphasize that the taxing power "is the one great power upon which the whole national fabric is based . . . as necessary to the existence and prosperity of a nation as is the air he breathes to the natural man." *Id.* America's national amnesia about the positive aspect of taxation is rooted in a distrust of government so deep-seated that some commentators view it as the defining element of the American personality.

Anti-tax sentiment is such a major component of this distrust that to be anti-tax in the United States is to be patriotic. Even within mainstream discourse, anti-tax rhetoric is replete with revolutionary and nationalistic allusions. Candidates for the 2000 Republican presidential nomination, for example, called taxation slavery (Alan Keyes) and a breeding ground for tyranny (Lamar Alexander). Former President Ronald Reagan called the pre-1986 tax system "un-American." In the late 1990s then House Ways & Means Chair Richard Armey (R–TX) and Representative Billy Tauzin (R–LA) referred directly to one of the nation's founding symbols by re-enacting the Boston Tea Party, but this time dumping the Internal Revenue Code into the Boston harbor. By invoking such defining historical events as the Revolutionary War (the ultimate protest against tax), this type of anti-tax rhetoric wraps opposition to tax in the American flag and ties it to core American principles of freedom and liberty.

Such rhetoric can be dangerous. Although users of this rhetoric may simply wish to reduce taxation, their language risks increasing opposition to taxation itself. Since taxation is fundamental to any nation's existence, undermining the legitimacy of taxation undermines a citizenry's willingness to pay tax that, in turn, can threaten the stability of its government. This is especially true in a nation where tax protests have historically served as a focal point for heated political battles about the nature and extent of government—battles that, on occasion, have been literally violent, not just figuratively so. Tax-centric revolts have occurred at critical junctures in America's history. The original Revolution that gave birth to the country is the most prominent, but there are also Shays' Rebellion, which some commentators view as instrumental to the signing of the Constitution, and the Whiskey Rebellion that tested that new constitution. In each instance, the protesters not only viewed taxation as a tyrannical exercise of governmental power, but also saw physical force as a legitimate method of fighting for liberty—the right of revolution being the ultimate tool in the arsenal in the battle for freedom.

The right arises from the compact theory of government. If government exists because the people have agreed to it, then the people have the right to resist illegal, oppressive government actions, and resist forcibly if necessary. Although the right of revolution was necessary in founding the nation, it is less functional – even dysfunctional – in maintaining the nation. Consequently, shortly after the Revolution, many people thought that the right to forcible resistance should end once a legitimate government was in place. Indeed, many people believed that the suppression of the Whiskey Rebellion effectively terminated the right to use force to resist unjust laws.

History shows they were wrong. Just a few years after the Whiskey Rebellion, another armed tax rebellion, the Fries Rebellion, resulted in one of the leaders being convicted of treason, although President Adams eventually pardoned him. In 1832, South Carolina nullified the 1832 protectionist tariff as a tyrannical, illegal act of the government and threatened to secede if federal agents attempted to collect. A military response by President Jackson was narrowly averted by the passage of a compromise tariff.

Even today, the right of revolution has only been domesticated, not eliminated. As with anti-tax sentiment, belief in this right exists in the mainstream as well as on the fringe. Respectable advocates of individuals' right to bear arms ground their second amendment claim in the right of revolution. A few state constitutions, such as New Hampshire's, explicitly recognize the right of revolution: "whenever the ends of government are perverted, and public liberty manifestly endangered, and all other means of redress are ineffectual, the people may, and of right ought to reform the old, or establish a new government. The doctrine of nonresistance against arbitrary power, and oppression, is absurd, slavish, and destructive of the good and happiness of mankind." (Art. 10) In the wake of fierce and destructive riots, the 1969 Task Force on Violence recognized that needed change in the United States often occurs only through violence, and stated "[i]f the Boston Tea party is viewed historically as a legitimate method of producing such change, then present-day militancy . . . can claim a similar legitimacy." Price M. Cobbs & William H. Grier, *Foreword*, in Task Force on Violent Aspects of Protest and Confrontation of the National Commission on the Causes and

PREVENTION OF VIOLENCE, THE POLITICS OF PROTEST (1969) xi.

Revolutionary anti-tax rhetoric reinforces this American belief in the people's inherent right of revolution. Although some people argue that this rhetoric—like all rhetoric—is meaningless, they are incorrect. Words, as political scientists, psychologists, and others know, are powerful tools that help frame and shape our world, and then drive us into action. Rhetoric helps bond a nation—especially one with a diverse population—by creating commonalties of feelings and experiences out of iconic words and phrases. Because it appeals to emotions and belief, rhetoric is essential to politics, which itself is a product not just of objective facts but of passions and emotions. In America, anti-tax rhetoric is exceptionally powerful due to the nation's deep-seated anti-tax sentiment and its long and patriotic history of tax protesters exercising their right of revolution to resist illegitimate governmental power.

Revolutionary anti-tax rhetoric—especially that used by government officials—can be immensely destructive. It can undermine the legitimacy of the government by helping transform government from "we the people" into "them," the "other," the "enemy"—something that Americans with their characteristic distrust of government are quick to do anyway. By calling taxation theft or tyranny, the rhetoric weakens the obligation of the citizenry to pay taxes and therefore potentially threatens the financial stability of the government. Less inflammatory rhetoric can also undermine the government. By limiting government's capacity to raise revenues to provide the services people expect, the rhetoric increases popular frustration and distrust of government.

Anti-tax rhetoric, however, also has a constructive aspect. It acts as a safety valve by providing a vehicle for expressing concerns about important government policies. This is especially true given the historical role of tax issues as a forum for raising fundamental issues about the nature of government.

Ultimately, anti-tax rhetoric and tax protest are as double edged as the power to tax itself. They have the power to both destroy and create. As one judge noted, tax protest is both the quintessential political protest in America but also, given its past history, potentially a "clear and present danger to the Republic." *U.S. v. Amon*, 669 F.2d. 1351, 1363 (1981)(McKay, *dissenting*).

Given the dual nature of both tax and tax protest, a true patriot cannot be only against tax, but must support some tax. A true patriot should encourage an open and informed national discussion about the appropriate methods and levels of taxation in a democracy, keeping in mind both the necessity for, and danger of, taxation. Justice Frankfurter once said, "the responsibility of those who exercise power in a democratic government is not to reflect inflamed public feeling but to help form its understanding[.]" *Cooper v. Power*, 358 U.S. 1, 26 (1958) (Frankfurter J., *concurring*). In the tax area this means leaders need to conduct a reasoned debate about tax policy that maintains the balance between taxation's power to destroy and its power to keep a nation alive. Unfortunately, many politicians who exercise power (or aspire to do so) have failed in this responsibility. Their revolutionary anti-tax rhetoric reflects, and even inflames, the public's feeling. It is time for them to be the leaders and patriots they claim to be. ■

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INTERVIEW WITH **JOHN BUCKLEY**, DEMOCRATIC CHIEF TAX COUNSEL, COMMITTEE ON WAYS AND MEANS

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

JOHN BUCKLEY

INTRODUCTION: John Buckley is the Democratic Chief Tax Counsel to the Committee on Ways and Means. In his 30 years of service on Capitol Hill, he has seen the tax legislative process from a number of angles, including that of a drafter in the House Legislative Counsel's office and Chief of Staff of the Joint Committee on Taxation. In this interview he shares his insights on the changing legislative process, as well as his perspectives on some of the key moments in the last 30 years of tax legislation, and his picks for best and worst tax legislation during that time.

Q Tell us about your career in the government.

A I am unusual in that I have spent all thirty years of my professional career as a congressional employee. I joined the House Legislative Counsel's office immediately after I graduated from Wisconsin Law School in 1973. The Legislative Counsel's office is responsible for the drafting of the statutory language. I came with only a couple of tax courses from law school and not much interest in tax law. After about a year, I was asked to join the tax drafting team and I spent 20 years drafting tax legislation as a member of that office. To the extent I know anything about tax law, I learned it during my years in the Legislative Counsel's office.

At its best, the drafting process was very much like a seminar in tax law with experts from the Treasury Department, Internal Revenue Service and Joint Tax Committee. The drafting process began with long discussions of the state of current law, including relevant rulings and court cases, and of how the legislation was to change current law. Only after those discussions were complete, would the actual statutory drafting occur. It was a fascinating process. Unless you were paying no attention whatsoever, you had to learn a lot. I was forced to pay attention.

From there I went to the staff of the Joint Committee on Taxation in 1994. It was a good time for a change. I had enough of drafting and every drafter always wants to be involved in policy. The change was a broadening of my experience on Capitol Hill, not just dealing with technical aspects of law, but also with the broader policy, revenue and distributional issues. It was a very interesting experience for me, even though it was largely consumed with consideration of Clinton's healthcare plan.

In 1995, I joined the Democratic staff of the Committee on Ways and Means, which was the first time I worked on a partisan staff. My current job involves very much of the same type of thing that I did at the Joint Committee, but dealing more directly with the Members of Congress. I feel privileged to have had the opportunity to do all of this. Obviously, things don't always turn out exactly the way you want, but it has been a tremendous experience.

Q How has the functioning of the Ways and Means Committee changed over the years in which you have been involved?

A Well, when I first started in the Congress, Wilbur Mills was the chairman and Barber Conable was the ranking Republican. It was often difficult to know who was the Democrat and who was the Republican. There was a very broad consensus on tax issues. The Committee bills came out with large bipartisan majorities. There always were several dissenting votes, but overall it was a fairly congenial operation. Now you have to understand that was in the context of the 1970s when most tax legislation consisted of tax cuts. They were returning what would have otherwise been inflationary tax increases. You did not have indexing of the tax rate brackets. So it was pretty easy to be congenial, because every year you were delivering good news. Also, you did not have the Congressional budget process intruding.

When I started, enactment of a major tax bill often was a two-year process. The Ways and Means Committee held hearings, marked it up, and then the House passed the bill one year. A similar process occurred in the Senate the next year. I think that was better than current procedures. You were able to get greater input from outside parties and probably a better statutory product. But today, often the legislative action has to be

pursued simultaneously on both sides of the Hill.

The compression of the process has been caused by the Congressional budget rules. Those rules involve the adoption of an annual Congressional budget resolution that contains directions for the revenue committees to report legislation accomplishing specific goals. Through the '80s it was mostly increased revenues. There would be a direction to increase revenues by a certain number of dollars to address the deficit. Recently, there have been directions to enact large tax reductions. It is often late May or June before you have a final budget resolution. All of the legislative actions happen between the adoption of the resolution and October 1st, so it is a very compressed schedule, and that is the reason why you get both revenue committees marking up at the same time.

The real change occurred in 1981, which was the first time that a tax bill was written as part of the budget process. Also, 1981 was the first time that tax issues basically became a defining difference between the two parties. In addition, the 1981 Act introduced indexing that guaranteed that most tax bills in the future would not be terribly good news. As a result of all of these factors, the process has become more contentious and less deliberative.

Q Whose idea was it to introduce indexing?

A The Reagan Administration proposed indexing in 1981. It did change the process. If you look at the period after 1981 and before 1997, you will not see the enactment of any significant tax reduction. All of the tax bills were generally tax increase bills and passed in the House on party lines. The only exception was the 1986 Act, which was roughly neutral. Most forget the size of the tax increases enacted in the 1980s, starting in 1982.

Q When indexing was being introduced in the early 1980s, do you think either party understood what a profound effect it would have on the tax legislative process?

A I don't think so. I think a lot of people don't appreciate even now that it really changed the whole process. Of course that could change in the future as more of us will pay the un-indexed alternative minimum tax.

Q Contrast the role of the Joint Committee, which you headed, with the Ways and Means Committee.

A They are two absolutely different institutions.

The Joint Committee nominally is a committee consisting of members of Congress. But it is only nominally a committee. Its real role is providing a staff of tax and economic experts. I worked in tax legislation for well over 20 years before I even attended a single meeting of the congressional members of the Joint Committee on Taxation. And the only reason I was there was because they were confirming my appointment as chief of its staff. I think I've gone to one or two meetings since.

The Joint Committee is a unique institution in Congress because it is a pool of experts that is shared by the Senate Finance Committee and the House Ways and Means Committee. It is a reflection of the congressional desire to control the tax writing process. If you get outside of tax legislation, the other committees of Congress rely on their own staff or Administration experts for their technical advice. No other House Committee in effect shares staff with a Senate Committee.

The Joint Committee is a staff resource. The actual writing of the legislation is done in the Ways and Means Committee and the Finance Committee, which are actual committees of Members of Congress

Q It may be obvious, but why do you think Congress chooses to have its own pool of experts on tax issues?

A Taxes have always been an issue over which the Congress has insisted on having fairly tight control. The only way it can do that is through an institution like the Joint Committee on Taxation; otherwise, you would have to rely on the Treasury Department for technical and policy advice. Congress is willing to do that in other areas, but it is unwilling to do it on taxes. It is worth noting that when Congress wanted greater control of the budget, it created the Congressional Budget Office, a large staff of budget experts.

Q We read that the number of lobbyists in Washington has gone from under 100 to tens of thousands in the last 30 years. How has that affected the tax legislative process?

A One of the beauties of being an employee of the legislative counsel's office is that you had absolutely no contact with any lobbyist under any circumstances. It was only in the last eight years that I have had any significant contact with lobbyists. I do not think it has changed a lot in the last eight years. However, my views of lobbyists have changed greatly. I do think the best of them bring some real knowledge and facts to the process that congressional staff need to know, and they play an important role. Sometimes I wonder why a company spends as much money as it does hiring people who then just call people like me to arrange a meeting with the company's executives, but that's another question. The information quite often is provided by the tax directors of the companies involved, and it is vitally important information.

Q How does the Hill interact with Treasury on tax issues?

A Treasury has always been a crucial part of the tax writing

process. If you look at major reforms, the '69, '76, and '86 Acts, they all are the result of Treasury initiatives. Often major technical changes are the result of Treasury initiatives. Also, Treasury has historically played a tremendous role in the tax writing process, both in setting the President's budget and often in setting the agenda for the year. Treasury has a very large impact in setting that agenda and then it also has had a fairly large impact in the technical aspects of the law. Treasury also historically has played the role of the bad cop in the process. That is one of the most important things Treasury has done in the past. Often when members have questions over the policy of some of the things that they are asked to do, it is very easy to be able to say that Treasury has the same objections. It is a thankless role that Treasury has played in the past, but I think it is a vitally important role. If you ever see a reform movement in the future it will be in my opinion the response to a Treasury or Administration initiative.

Q In earlier times the Service had a person at the table for legislative drafting sessions. That is no longer the case. Do you know why, and is it a problem?

A Well, this is one area where I must say I have strong feelings. When I started, the Internal Revenue Service was present at every drafting session along with Treasury representatives and Joint Committee representatives. They were a valuable and important part of the process. They brought an historic knowledge that the Treasury officials often lack because of their short government service. The IRS people asked difficult questions. Often, they slowed the process down and made people answer difficult questions. As inconvenient as that may have been, I think it was extraordinarily valuable. That is one reason why I think it is unfortunate they are not there. I think the legislative product has suffered and I am speaking here as an old legislative drafter.

The other reason why I think that absence of IRS from the drafting is a bad idea is that it is much easier to understand the statute and the intent of Congress if you were there when people were translating the Congressional policy into statutory language. It is very easy for me to read the statute and understand what was intended, because I was there and can remember what people were attempting to do. I think the regulatory process has suffered because the IRS now is in the same position that you private lawyers are in—looking at the statute and committee reports and trying to figure out what Congress had in mind. When they were present in the past they had a much better understanding of what was going on. It was purely a Treasury decision to exclude them.

Q What pieces of tax legislation enacted during your career do you consider to be the best and the worst, and why?

A Picking the best is easier. I think the '86 Act was the best, both from the process and from the ultimate product. There was a bipartisan agreement on some basic ground rules. Both parties were going to set their priorities aside. The legislation was not going to increase or decrease revenues; the size the government was to be held constant; it was not going to change the distribution of the tax burden. And once those issues—which really are the issues that quite often divide the two parties—were set aside, everybody sat down and tried to figure how to write the best law that was consistent with those objectives. Whatever you think of the '86 Act, I think it was the best tax bill that I ever worked on, and it is one in which I take a fair bit of pride.

The worst is a more difficult decision. I would say that the 2001 and 2003 tax bills are the worst. That may not surprise many people, but my reasons for saying that may. I do not say that because those bills are technically flawed or are unfair from distributional standpoints. I say that because of all of the budget gimmicks contained in those two laws. I think the budget rules and budget games have just had a terrible impact on our tax laws. You look at those two laws and you have sunrises, you have sunsets, you have provisions that start the middle of the budget periods and end before the end of the budget period. As a result, we have a law now that I think is extraordinarily unstable. Before 1939, Congress enacted tax laws on a biannual basis just like they did appropriations acts. Every two years Congress enacted a new revenue act that basically supplanted all revenue acts previously enacted. In 1939, Congress decided that a stable legal structure for our tax law was necessary so that people could plan and make business decisions. I think we are almost back to pre '39 law. I have no idea what the estate and gift system will look like in the future. I have no idea what the capital gains rate is going to be in the future. It is far easier for practitioners to deal with complexity than with uncertainty. It is not optimum, but you can figure out complicated laws. I have been involved with Congress for thirty years and I cannot predict the future. People who make an estate tax plan now have to predict or anticipate what Congress may do in the future.

The other part of the recent tax cuts that I deplore is the use of the alternative minimum tax to deny, in effect, a lot of the nominal tax reduction that was promised in the big print of the bill. My guess is most people who read your *NewsQuarterly* will be computing their taxes under both regular and minimum tax systems. We have dramatically increased the complexity and dramatically increased the uncertainty of our tax laws, and I just think it is a bad result.

Q Please explain your view on the issues of helping U.S. businesses obtain a level tax playing field abroad and the effectiveness of Subpart (F).

A The international tax rules need to be a balance of competing objectives. We want our companies to be competitive overseas. I firmly

believe that. However, we don't want our tax rules overseas to be so liberal as to create incentives for U.S. companies to move operations out of the United States. I think that balance has been lacking in the current debate on international tax changes.

Every tax director I have ever talked to about international changes has made these similar points. First, they will admit that the non-tax considerations such as labor rates, environmental standards, and access to markets are the most important factors that they look at when they decide where to locate their operations. However, taxes are always on the list. They may not be on the top, but they are on the list. Also, they are more than willing to concede that they look at respective tax rates when they decide where to locate their plants and almost all of them are willing to concede they can get tax reductions overseas that they couldn't get in the United States under current law. So we need to discuss this issue with some sense of balance between the need to have our companies be competitive overseas and the desire not to create undue incentives to locate offshore.

In my opinion a true reform of the international rules is necessary. They are unduly complex, but they raise almost no money. I've always had a hard time dealing with the argument that they need revision because they're unduly burdensome on overseas operations when they raise very little money. I think the effective U.S. rate on active business earnings overseas is about 1.9%.

Now, the other troubling aspect of your question is its implicit assumption that our tax laws pose competitive disadvantages to our multinationals overseas. I think the evidence is not all that clear that that is correct. Last year they had a hearing on International Competitiveness in the Ways and Means Committee, and they had a witness from an accounting firm downtown who was making an impassioned speech that our tax laws pose competitive disadvantages to our companies when compared to the partial territorial systems that some European countries use. One of the members of the committee asked the obvious question, "If that is the case, why don't we simply enact a territorial system such as what Europe has?" The witness immediately denied the obvious implication of his testimony claiming that was not what he was trying to say. He said that we do not want to enact that type of territorial system.

That was the first time that I felt compelled to actually look at the impact of our system overseas. It turns out that our system in many respects is more generous than the partial territorial systems of other countries. If you operate in a low tax jurisdiction overseas, deferral gives you benefits pretty close to an exemption. There has been a study by a Treasury economist that says repatriations of earnings from low tax jurisdictions typically don't occur for 15 years. If you operate in a high tax jurisdiction overseas, our system provides greater benefits than an exemption because you can use the excess foreign tax credits from those jurisdictions to offset the tax on other income.

There was a study published by the American Enterprise Institute two years ago on what would happen to tax receipts if we adopted a partial territorial system in this country. The answer of that study written by two Treasury economists was that taxes would go up, not down. When you have economists telling you that a territorial system similar to what is used in Europe would increase, not decrease, tax burdens on U.S. multinationals, then I begin to wonder whether this argument about unlevel playing field overseas has a lot of merit.

I think there needs to be a greater examination of what is occurring overseas and how our rules operate overseas, but that has not yet occurred in this process. Now I am not saying our rules are appropriate or not in need of reform; don't get me wrong, there are many aspects of our rules that I think are unfortunate. They're complicated, raise little money, create incentives for companies to keep earnings offshore. It is hardly an optimum system, but none of those things are really being addressed by the current international proposals.

Q Well, do you think we'll get a VAT?

A In my opinion, the only way you are going to see a valued added tax is under one of two scenarios. First, it would be part of a large major restructuring of our tax laws, to replace all or part of the individual income tax or corporate income tax system. I don't think that's ever going to happen.

The first problem is transition There is a double tax when you go from an income tax to a value added tax. It will particularly impact the elderly and other individuals who are financing their current standards of living by using savings that they've accumulated under an income tax. Currently they have little tax burden. If you substitute a value added tax for an income tax, all of a sudden they would be paying tax again on the consumption of the income that they've paid tax on under the income tax system. I think it is a large problem.

Another problem is distribution. There's no question that a value added tax is regressive compared to the individual income tax. It is a consumption tax across the board. Any attempt to address regressivity in a value added tax is complicated; in effect you create a negative income tax system. Also, there is a dramatic increase in the rate, which has the effect of dramatically increasing the number of individuals subject to the negative tax system. You kind of chase yourself around the block here.

You have to understand that 50 million households in this country pay no federal income tax or receive refunds from the earned income tax credit. If you care about distribution, those households and others with small tax liabilities will have to receive a rebate of the VAT. You might have more peo-

SEE **BUCKLEY**, PAGE 25

SPOTLIGHT ON COMMITTEES: FOREIGN ACTIVITIES OF U.S. TAXPAYERS

by Peter H. Blessing, New York, NY

Faust, of course, was the legendary academician who, having mastered law and philosophy, science and literature, and every other branch of learning, was tempted by the devil to trade his soul for the pleasures of the body and youth. Our FAUST Committee—Foreign Activities of U.S. Taxpayers—engages in activities that may be a tad less colorful but are, we think, no less stimulating.

While a cliché, the world today is truly a global community in which most major business transactions are cross-border in some sense. This factor underlies the surge in relevance of, and interest in, the FAUST Committee and its companion committees that focus on cross-border issues (U.S. Activities of Foreigners and Tax Treaties (USAFTT), Transfer Pricing, and Foreign Lawyers Forum (FLF)).

From a U.S. tax advisor's standpoint, many of the most interesting and complex cross-border issues arise in the outbound context (foreign investment and activities of U.S. businesses), the home turf of the FAUST Committee. The reason is simple: the United States exercises its taxing jurisdiction over the worldwide income and activities of U.S. corporations and other persons. This jurisdiction is exercised not only over direct operations but also over operations conducted through foreign subsidiaries (controlled foreign corporations or "CFCs"). The areas in which our Committee exercises jurisdiction thus include provisions governing the foreign tax credit (including sourcing and expense allocation rules), income of CFCs (subpart F), outbound M&A and joint venture transactions, liquidations and reorganizations of CFCs, foreign exchange transactions, export incentives, dual consolidated losses, the impact of the "check the box" entity classification regulations on outbound transactions, and so forth.

The tax laws in this area reflect the tension between the need to retain taxing jurisdiction over all the income of U.S.-owned enterprises and the policy of promoting the competitiveness of U.S. multinationals. Currently, Congress is considering some of the most sweeping legislative changes in decades.

The companies that are most interested in the FAUST Committee's activities include some of the world's largest corporations, since they typically have the most far-flung operations. For example, our current Committee Chair, Joe Luby, is from ExxonMobil and our Subcommittee Chairs include practitioners from corporations such as GE Capital, the large financial unit of General Electric.

The FAUST Committee is a leader in the Tax Section in involving representatives of industrial concerns and financial institutions. Our Committee presents an excellent opportunity for interaction between "in-house" advisors and external advisors. We also make an effort to involve law school professors and other academics.

The core activity of our Committee occurs at the subcommittee level. Currently, there are eight subcommittees, six covering the areas in which the Committee has primary jurisdiction, one devoted to CLE, and one to legislation and other developments. A major responsibility of the subcommittees is the preparation of submissions to Treasury and the Service on cross-border matters of current interest, including regulation projects and pending legislation. Participation in the preparation of these reports is not only an opportunity to work with top professionals from a variety of organizations but to have a real voice in the development of U.S. law affecting cross-border transactions.

Our subcommittees are also the incubators for the topics and composition of the various panels assigned to present at the FAUST committee meetings held during each of the three annual Tax Section meetings. Those panels regularly include one or more government representatives. The preparation for these presentations is an excellent way to get to know those in a position to affect the tax laws with which we live and work.

The FAUST Committee works closely with the Foreign Lawyers Forum. As a result of their networks of CFCs, foreign branches or disregarded entities, and joint ventures, U.S.-based multinationals often consider taxation in foreign countries to be just as important as U.S. taxation and the networks formed through interaction with members of the Foreign Lawyers Forum can be invaluable in developing this knowledge.

The FAUST Committee also works closely with the USAFTT Committee. Many FAUST Committee members have valuable experience and interest in "inbound" activities of foreign-based businesses. Further, in some cases, CFCs themselves may have inbound issues. Finally, most CFCs have income tax treaty issues; while these often arise under treaties to which the United States is not a party, the treaties and the issues are similar to those arising under U.S. income tax treaties.

In addition, the FAUST Committee has a special relationship with the Transfer Pricing Committee, which in fact was created from the FAUST and USAFTT Committees a few years ago.

Apart from collaboration with other committees in the Tax Section,

PRO BONO UPDATE: NOW IT'S EASIER THAN EVER TO BECOME A VITA VOLUNTEER

by Brian P. Trauman, Washington, DC

WHAT IS VITA?

The IRS Volunteer Income Tax Assistance (VITA) nationwide program was organized to provide free assistance to low-income, elderly, disabled, and other individuals who require assistance in preparing their tax returns and cannot afford the services of a paid professional tax preparer. The VITA program provides an excellent pro bono opportunity for Tax Section members who want to dedicate some time this filing season to assisting deserving taxpayers, and now, thanks to the efforts of the Tax Section's Pro Bono Committee, it is easier than ever to volunteer.

VITA'S NEW RELAXED TRAINING REQUIREMENT

The Section's Pro Bono Committee recently reached an agreement with the Service whereby all attorneys in good standing with a state bar will not be required to attend training with respect to taxes or tax preparation. This allows tax and other practitioners familiar with the issues common to the VITA beneficiaries to spend their valuable time volunteering, rather than in a training session. Attorneys not familiar with the issues are encouraged either to attend training sessions or educate themselves. The Pro Bono Committee's website (www.abanet.org/tax/groups/probono) contains contact information for training sites and times, and self-teaching materials. Additionally, the Service has indicated that it is willing to bring the training to your organization's conference room. Please note: the Service is still requiring at least two hours of software training prior to preparation of returns, but this requirement seems to be administered on a site-by-site basis.

HOW TO BECOME A VOLUNTEER

This is the first year the Service has agreed to relax the training requirement, so the Tax Section would like to take it as a challenge to increase volunteer turnout from its ranks. Your assistance fills an important need in your community, enhances the public's understanding of the tax system, and answers the legal profession's common calling to serve the public good, so please volunteer for as little or as much time as you choose, but please choose to volunteer.

Here's how:

- **Step 1:** Contact your Territory Manager (see www.abanet.org/tax/groups/probono) and request your local VITA coordinator's information.
- **Step 2:** Contact your local VITA coordinator to choose a time and location to volunteer, and find out the local software training requirements.

After you volunteer, please go to the feedback form on the Pro Bono Committee's website (www.abanet.org/tax/groups/probono) and tell us about your experience. ■

we work with other bar associations, in particular the International Bar Association, in planning and presenting programs jointly both in the United States and abroad. Joint ABA–IBA events in 2004 will include programs in Zurich and in New York City, addressing topics such as how and where to structure the global business, techniques to finance the global business, and the dramatic effect of recent European Court of Justice decisions on European cross-border legislation.

We in the FAUST Committee are interested in expanding our membership to include any and all who may be interested, and we have a particular need for members who have the energy to help on our Government submissions and other projects. We are proud to have a very active Young Lawyers contingent and cannot emphasize too much that prior experience in the outbound area is not necessary.

Like our namesake Dr. Faust, who chafed in the absence of something as interesting as the cross-border tax issues faced by multinationals, we just want to have fun.

Persons interested in joining the FAUST Committee should contact:

Joe Luby at joe.o.luby@exxonmobil.com

Peter Blessing at pblessing@shearman.com

Charles Bruce at cbruce@mooreandbruce.com, or

Giovanna Sparagna at gsparagna@sablaw.com. ■

NEWS **BRIEFS**

MARK YOUR CALENDAR FOR **TWO IMPORTANT INTERNATIONAL TAX PROGRAMS** IN 2004

The American Bar Association Section of Taxation and the International Bar Association (IBA) present the Fourth Annual International Tax Conference on **"Tax Planning Strategies-US and Europe."** The conference will be held at the UBS Conference Center, Zurich, Switzerland, March 5-6, 2004.

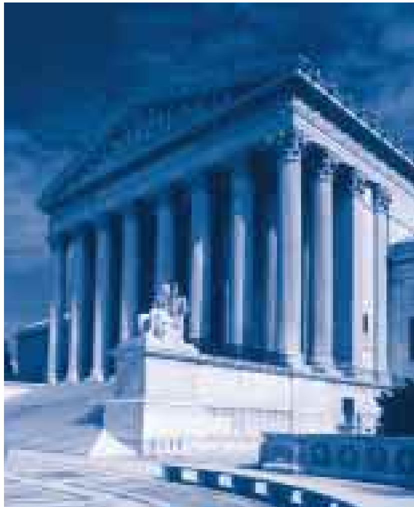
Topics will include: Transfer pricing developments in the U.S. and the EU and their impact on planning strategies; the impact of ECJ and EU initiatives in European tax legislation; new legislation affecting collective investment vehicles and the effect on investments to and from Europe; the impact of the Societas Europaea vs Inspire Art Ltd; locating and managing the global business; and financing the multinational business.

Later this spring, on June 10-11, 2004, the Section, together with Fordham University School of Law and the IBA, will present the **Second Annual International Tax Institute** at Fordham in New York City.

For more information about both programs, go to www.abanet.org/tax/.

NATURAL DISASTER TAX RELIEF

Wildfires in California, a major hurricane on the East Coast, floods and tornadoes in the South—these were a few of more than 50 natural disasters that were declared "Presidential Disasters" in 2003. To assist taxpayers who suffered casualty losses in these disasters, the Section recently compiled a list of questions and answers (Q-and-A's) designed to highlight the basic federal tax treatment of disaster losses resulting from the damage or destruction of property in an area determined by the President to warrant federal disaster assistance. Some of the questions covered include: What type of tax relief am I entitled to?; How do I calculate my disaster loss?; I don't own a home, but my rental residence and its contents were destroyed: Am I still entitled to tax relief?



To promote this valuable public service, Section Chair Richard Shaw participated in a "radio news tour" with the leading news and information radio stations in Los Angeles and San Diego. His interviews were broadcast to more than two million listeners in the Southern California region. Dick invited listeners to visit the Section's public information website at www.taxtips4u.org to get a complete list of the Q-and-A's, as well as a link to important IRS documents and worksheets. As always, listeners who were affected by the disaster were encouraged to consult their tax advisor for information about how these special tax rules may apply to them.

13TH ANNUAL ABA/IPT EVENT- MARCH 23-26, 2004

The ABA Section of Taxation and the Institute for Professionals in Taxation (IPT) join forces again to present the 13th Annual Advanced Sales/Use Tax and Advanced Property Tax Seminars. The seminars will take place on March 23-26, 2004, at the JW Marriott Hotel in New Orleans.

Both seminars will feature sessions on current developments and ethics. In addition, the Sales/Use Tax topics to be presented include: SSTP-Streamlined Sales Tax Project and State Legislation; Local Tax Issues & Controversies; Mergers & Acquisitions; Mixed Transactions—The True Object Test; and a Senate Finance Committee Mock Hearing. The Property Tax topics include: What is Realty As Opposed to Personality for Property Tax Purposes; Realty Transfer Tax; Land Value Taxation; a Demonstration of an Assessment Appeal Negotiation; and Extraction of Business Value from Value of Real Estate.

For the latest schedule and registration information, visit the Tax Section's website at www.abanet.org/tax/meetings/. ■

WWW.ABANET.ORG/TAX/

YOUR SOURCE FOR IMPORTANT TAX SECTION INFORMATION, INCLUDING:

• Section *NewsQuarterly* and *The Tax Lawyer* Online • Upcoming Section Meetings
• *Comm-Online* (online, searchable database of committee program materials)
• Recent Government Submissions and Testimony • Membership Directory • IRS Notifications
• Careers • E-mail Discussion Groups • Consumer Information—*TAXTIPS 4 U*
• Extensive links to other helpful tax sites

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

You are cordially invited to a

Breakfast with IRS Commissioner Mark W. Everson

The Section of Taxation is pleased to announce that Mark W. Everson, Commissioner of Internal Revenue, will speak at the

2004 May Meeting on Friday, May 7, 2004, at 8:00 a.m.

Although the breakfast is complimentary, it will be a ticketed event and members must register to attend using the May Meeting Registration and Ticket Purchase Form available online or in this issue of the *NewsQuarterly*.

The 2004 May Meeting will take place on May 6-8 at the Grand Hyatt Washington in Washington, DC. For a complete description of more than 250 committee programs, special events, and activities scheduled for the meeting, please visit our website at www.abanet.org/tax/meetings.

We hope to see you there!

INTERVIEW WITH JOHN BUCKLEY

FROM PAGE 21

ple filing individual income tax returns under such a system than do now. It is much easier not to collect the tax from these families as we do now than collecting a tax and then giving it back.

Other important issues involve housing and healthcare. They both receive large benefits under our current income tax system.

But, in 1995 I actually thought that a VAT could happen. You had a Chairman of the Ways and Means Committee who was committed to doing exactly that. You had some support on the Democratic side for examining the concept. You know, Chairman Archer never put forth a bill, and I think, in part, it was because of the factors I've talked about.

Q What is your second scenario?

A The only other possibility is that you could see a value added tax in addition to our current structure. That's essentially what Europe has done. Europe has large value added taxes, but they are in addition to income taxes and payroll taxes that are equivalent to or higher than ours. And I don't think that is a likely scenario either, unless the budget problems get so severe going forward, and that I just cannot predict. I think neither scenario is likely, but I think the first is extremely unlikely and the only question on the second is, do the budget pressures get so bad that they have to do something.

Now, the argument that Europeans have competitive trade advantages because they use value added taxes, in my opinion, always ignores the fact that they have income taxes and payroll taxes similar to ours. The Joint Committee did some wonderful tables about a year or two ago comparing our tax system to Europe's. Our individual income tax burden is higher in this country than in Europe. However, our corporate taxes are lower as a percentage of our economy. Our payroll taxes are dramatically lower as a percentage of our economy, and our consumption taxes just do not even compete. I mean, this is a great country to be a consumer in, because we have such a low consumption tax burden. But those value added taxes don't replace the corporate income tax, they're just added on top, because the government is so much bigger over there. ■

2004 SECTION OF TAXATION 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 MONDAY, APRIL 5, 2004

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

Group: ABA Section of Taxation
Group Dates: 5/4/04 – 5/9/04

Name ______________________________

Affiliation ______________________________

Address ______________________________

City ______________________________

State ____________________ Zip ________

Phone ______________________________

Fax ______________________________

Room Requests

______ Non-Smoking Room

______ Handicapped Accessible Room

Arrival Date __________ Departure Date __________

Arrival Time __________ am __________ pm

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

The Grand Hyatt Washington regrets that it cannot hold your reservation after 4:00pm 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 3:00pm. 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 3:00pm on the day prior to arrival to avoid forfeiture of deposit**. Please provide credit card information or indicate paying by check or money order.

______ King Bed ______ 2 Double Beds

	CONVENTION RATES	BUSINESS PLAN*	RC**
Single Occupancy	$230	$250	$270
Double Occupancy	$250	$270	$290

One bedroom suites available upon requests.
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.

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

______ Single/Double Occupancy $225

______ King Bed or ______ 2 Double Beds

Check-in time is 4:00pm or earlier based upon availability. Check-out time is 12:00 noon. Make checks payable to "Marriott Metro Center".

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

2004 SECTION OF TAXATION MAY MEETING REGISTRATION AND TICKET FORM

EARLY BIRD DEADLINE: APRIL 1, 2004*

*A **completed** registration form along with **full payment** must be **postmarked or faxed** by **April 1, 2004,** to qualify for the early bird registration fee. Registrations received after this deadline will be automatically processed at the higher registration fee.

FINAL REGISTRATION DEADLINE: APRIL 28, 2004**

A **completed registration form along with **full payment** must be **received** by **April 28, 2004, to be pre-registered**. Registrations received after April 28, 2004 will be returned, and you will be required to register on-site.

CANCELLATIONS: $50 processing fee. NO REFUNDS after April 14, 2004.

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*: ____________________

Confirmation will be sent by email.

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 FEE

If Postmarked or Faxed	*by 04/01/04*	*after 04/01/04*
Check one:		
Regular Member/Associate	❑ $440	❑ $490
Foreign Lawyer	❑ $440	❑ $490
Young Lawyer *(admitted to the Bar less than 3 years)*	❑ $340	❑ $390
Full-Time Law Professor	❑ $130	❑ $140
Government Official	❑ $130	❑ $140
Full-Time LITC Employees	❑ $130	❑ $140
Non-Section Member*	❑ $490	❑ $540
Full-Time J.D./LL.M./MT Candidate	❑ waived	❑ waived
First Time Tax Section Attendee**	❑ waived	❑ waived

*ABA members registering will become Tax Section members for 2003-2004.

**First Time Tax Section Attendees must attest to the following 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 + $12.95 S/H
❑ Meeting Materials traditional book version	$65.00 + $12.95 S/H

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

TOTAL: $__________

TICKETED EVENTS

FRIDAY, May 7th

TOUR/ACTIVITY
1 Mt. Vernon Tour and Luncheon ___ at $80 each = $_____

SECTION BREAKFAST
2 Breakfast with Commissioner Everson ___ at $0 each = $__0__

COMMITTEE LUNCHEONS
3 Administrative Practice and Court Procedure & Practice ___ at $48 each = $_____
4 Business Cooperatives & Agriculture ___ at $48 each = $_____
5 Banking & Savings, Financial Transactions, Insurance Companies, 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, FLF, Transfer Pricing and USAFTT ___ at $48 each = $_____
11 Partnerships & LLCs 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 8th

COMMITTEE BREAKFAST
15 Partnerships & LLCs, Real Estate and S Corporations ___ at $36 each = $_____

LUNCHEON
16 Section Luncheon ___ at $48 each = $_____

PAYMENT INFORMATION

TOTALS:

Registration Fee	$ ________
Additional CD-ROM	$ ________
Ticketed Events Total	$ ________
TOTAL PAYMENT:	$ ________

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

Check One: ❑ Master Card ❑ VISA ❑ AmEx

CARD NO.: ____________________

EXP. DATE: ____________________

SIGNATURE: ____________________

Return to:

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

For Tax Section Use Only (POS 12-31:P1)
Check # ____________
Amount Rec'd $____________
Initials ____________

TAX BITES

by Gail Levin Richmond, Fort Lauderdale, FL

HUMMER, 1 – SECTION 280F, 0

A Scorekeeper's Limerick

When buying a new business car,
The taxpayer looked wide and far.
He was happy to wait,
For a 6K pound weight,
And avoid the 280F bar.

But why should your editors have all the fun? Judges regularly introduce literature (great and not-so great) into their tax opinions. Tax lawyers aren't narrowly focused number crunchers. Enjoy the three examples below. Then let your creativity run rampant. Send your contributions (humorous tax "events" or stories, literary references in tax cases, or original limericks, haikus, and the like) for inclusion in future issues.

"There should be joy somewhere in Milwaukee—the district court's judgment is affirmed."

Bauer, J., paraphrasing from Ernest L. Thayer, "Casey at the Bat," in *Selig v. United States*, 740 F.2d 572 (7th Cir. 1984) (appropriate amount allocated to amortizable player contracts).

"The tax court does not suggest that Simone held a place in decedent's life similar to that held by his kin. Nor did the Commissioner introduce evidence to support such a theory, even though it advised the trial court it would do so. As a consequence, Gloeckner's relationship with Simone strikes us as 'a little more than kind,' but certainly 'less than kin.'"

Cardamone, J., paraphrasing from William Shakespeare, *Hamlet*, Act I, Scene II, in *Estate of Gloeckner v. Commissioner*, 152 F.3d 208 (2d Cir. 1998) (valuation of stock in closely held corporation).

"Although Mrs. Shanbaum had to prove that there were substantial understatements of tax attributable to grossly erroneous items of Mr. Shanbaum, . . . she did not introduce the joint income tax returns for the years at issue or any other evidence that would shed light on the source of the Shanbaums' tax deficiencies. It is like going to see Shakespeare's Hamlet and finding no Hamlet on the stage, nothing rotten in the state of Denmark, and no ghost frightening the palace guards."

Goldberg, J., in *United States v. Shanbaum*, 10 F.3d 305 (5th Cir. 1994) (claim for innocent spouse relief).

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