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Section of Taxation
NEWSQUARTERLY

POINTS TO REMEMBER

How Pro Bono Tax Professionals Can Help Low-Income Taxpayers Claim the Earned Income Tax Credit*

By Kate Leifeld†

The Earned Income Tax Credit (EITC) is one of the largest sources of welfare benefits in the United States. *See* Internal Revenue Service, *About EITC*, *available at* http://www.eitc.irs.gov/central/abouteitc/. In healthy economic times, the EITC can be used by low-income taxpayers to obtain safe housing, an education, or to keep as a safety net. In our current economic climate, the EITC has become even more important as families are struggling harder to make ends meet. For tax year 2011, a taxpayer with three or more children can qualify for up to $5,751 in EITC benefits. A taxpayer with two children can qualify for up to $5,112; a taxpayer with one child, for up to $3,094; and a taxpayer with no children, for up to $464 in benefits. Rev. Proc. 2011-12, 2011-2 I.R.B. 297, 299.

However, people who claim the EITC are subject to a high level of audits by the Service due to noncompliance. As of 2008, approximately 36% of all individual audits are EITC audits. Internal Revenue Service, *Data Book*, *2008*, Table 9a (including n.4), *available at* http://www.irs.gov/pub/irs-soi/08databkrevised.pdf. At first blush, it would seem that audits successfully deter otherwise ineligible taxpayers. However, a recent study by the National Taxpayer Advocate (NTA) indicates that fraud does not account for all EITC noncompliance. The NTA found that represented taxpayers were almost twice as likely to be found eligible for the EITC as compared to their unrepresented counterparts. National Taxpayer Advocate, *2007 Annual Report to Congress*, vol. 2, at 96, *available at* http://www.irs.gov/pub/irs-utl/arc_2007_vol_2.pdf. This article explores how pro bono tax professionals can make a meaningful difference in the lives of low-income taxpayers.

How the EITC Works

Unlike other welfare benefits, where the recipient must apply and be approved, taxpayers claim the EITC by filing a tax return. Of course, this means that they must understand the EITC rules in order to determine their eligibility. A taxpayer is eligible to claim the EITC if all of the following section 32 requirements are met:

- The taxpayer has earned income, which is defined in section 32(c)(2) as "(i) wages, salaries, tips and other employee compensation ... plus (ii) the amount of the taxpayer's net earnings from self-employment for the taxable year ...." Earned income does not include child support, unemployment or Social Security benefits, or similar items.

* A version of this article originally appeared in *Maine Lawyer Review*, Oct. 22, 2009.

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September 13-15, 2012	JOINT FALL CLE MEETING	Westin Boston Waterfront – Boston, MA
January 24-26, 2013	MIDYEAR MEETING	Hilton Bonnet Creek & Waldorf Astoria – Orlando, FL
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FROM THE CHAIR

The Health of the Tax Section

By Charles H. Egerton*

I write this, my last column as Chair of the Tax Section, having just returned from a presentation to the Texas Federal Tax Institute which has a long-standing practice of inviting the ABA Tax Section Chair to address a luncheon session of the Institute. After completing my remarks, I opened the floor for questions from the audience. One of the questions posed to me was, "How would you assess the health of the ABA Tax Section?" I don't know whether the questioner was simply curious or was expressing a genuine concern. I responded to the question but on the plane trip back home, I pondered both the question and my response and ultimately came to realize that this would be a timely topic for my last column.

The health of the Tax Section can be measured in a variety of ways. Numerically, we currently have approximately 23,000 members, which is up slightly from the prior year, and attendance at our Fall, Midyear, and May meetings has held steady for the past two years despite going through the nation's worst financial downturn in 80 years. Despite the loss of some sponsorship income as a result of the recession, the Section is very sound financially and has accumulated significant reserves to fund future needs. Due to the outstanding work of our committees, the Section continues to provide the best CLE at the most reasonable price available anywhere in the country. On the topic of CLE presentations, one of the most encouraging signs to me as I attended panel presentations at the most recent May meeting in Washington was the number of new, young, and diverse faces that were included on a large number of these panels.

The Section continues to produce a large number of quality technical comments to Treasury and the Service, and during the past year we have submitted comments to Congress under the ABA's Blanket Authority Procedure. It is also anticipated that approximately 28 more sets of comments will be submitted to Congress this fall when the committees complete their tax reform recommendations to Congress. In addition, we have provided our members with a steady stream of quality publications including *The Tax Lawyer*, the *NewsQuarterly*, and a variety of other educational materials.

These are perhaps the most visible signs of the Section's health, but there is so much more that is done on a regular basis, activities of which I suspect most of our members are not aware. For example, the Section has both continued and expanded its commitment to pro bono legal service under the able leadership of the Pro Bono Committee, our Public Service Fellowship Committee, and our pro bono staff member, Rachel Ney. On another front, our Young Lawyers Forum (YLF) continues to play a crucial role in providing a nucleus to attract and retain new members and make them feel at home. This is the lifeblood that will nurture the future growth and well-being of the Section. We have been very fortunate to have continuing strong and energetic leadership within YLF. Included among the activities of the YLF is the first timer's dinner and reception that is held at each of our meetings and the staging of the highly successful Tax Challenge competition which exposes both regular law students and LL.M. candidates to the practice of tax law and the activities of the Tax Section. You can read more about the Section's pro bono activities and the YLF Tax Challenge in this issue of the *NewsQuarterly*.

One of the first things I learned when I assumed my responsibilities as Chair is that the Tax Section is truly blessed to have a staff that is second to none. Christine Brunswick, who has served as Section Director for 25 years, became my invaluable right-hand person from my first day on the job. There has not been a day during my term that I have not relied on her institutional knowledge, her insights into the inner workings of both the Tax Section and the ABA, and her wisdom and good common sense. Chris has also assembled an outstanding staff around her, and I have enjoyed working with each and every one of them.

It has also been my privilege and good fortune to have been surrounded by an extraordinary team of officers and Council directors who, individually and collectively, provided leadership to the Section and carried out their responsibilities exceptionally well. I want to extend my special thanks to Fred Witt, our Vice-Chair of Administration, Kathy

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Keneally, Vice-Chair of Committee Operations, John Barrie, Vice-Chair of Communications, Helen Hubbard, Vice-Chair of Government Relations, Emily Parker, Vice-Chair of Professional Services, and Doug Mancino, Vice-Chair of Publications, for their invaluable assistance to me and their service to the Section during this past year. It has been a pleasure to serve with each of them.

It has been my great privilege to have served as your Chair during the past year and I thank each and every member for giving me the opportunity to do so. I can assure you that I am turning the Section over to very capable hands when Bill Paul succeeds me as Chair of the Section this August. I have worked with Bill on Section activities for many years and it has been a special privilege for me to work with him in his capacity as Chair-Elect during this past year. Bill and his new team of officers and Council directors will do an outstanding job for the Section.

In summary, the ABA Tax Section is alive and well, and we have a great future ahead of us. ■

From the Chair-Elect

By William M. Paul*

I have the honor and good fortune to serve as Chair of the Tax Section for 2011-2012. I am grateful for this opportunity and look forward to a challenging and (hopefully) productive year.

My involvement in the Tax Section dates back to the late 1980s. I have held a number of different positions in the Section over the years, and have benefited greatly from the experience. Perhaps my most interesting experience was as Chair of the Tax Shelter Task Force from 2002 to 2005. Those were turbulent times as the government took numerous and varied steps to respond to the proliferation of sophisticated tax shelters that began in the mid-to-late 1990s. The government's responses were broad-ranging and necessary, but they imposed additional and on-going burdens on practitioners to evaluate transactions not only as to the merits, but also with an eye toward compliance with the reportable transaction rules, the material adviser rules, the Circular 230 rules relating to written tax advice and a variety of overlapping and potentially severe penalty regimes applicable to both taxpayers and advisers. Analyzing these "meta" issues can be very time consuming and nice judgments are often required.

Now that the government has largely succeeded in stopping the widespread use of tax shelters, it's time to step back and assess whether all the cumulative changes are really needed. This is particularly true in the penalty area, where Congress seems to have added new penalties and "enhanced" existing penalties on an annual basis. Unfortunately, some of the changes appear to have been made for revenue-raising purposes, rather than to regulate behavior and foster compliance.

Of particular concern are substantial, no-fault penalties that lack a reasonable cause exception. The most controversial example is the new penalty for transactions that lack economic substance. The economic substance doctrine is often invoked by the government to challenge transactions it does not like, but predicting when the government will assert the doctrine and when it will not can be extremely difficult. There are no bright lines here. The lines between transactions that pass muster (or equivalently that the government will decide not to challenge) and those that don't are at best dimly lit. The combination of substantial no-fault penalties, a vague standard for determining whether they apply and broad discretion on the part of the IRS as to whether to assert the doctrine, is troubling. The time is ripe for a review of existing penalties and for undertaking an effort to coordinate and rationalize the various penalty provisions that exist.

The need for penalty reform leads to the larger issue of tax reform, which has been much in the news. As I write this column in early June, the focus is on extending the debt ceiling, with Moody's threatening an unthinkable downgrade of the government's AAA credit rating. The tax reform process cannot be completed in the time frame in which Congress must address the debt ceiling, but it appears that tax reform, if undertaken at all, will be constrained by the presence of structural deficits. Unlike the 1986 experience, when Congress enacted tax reform on a revenue-neutral basis, it is difficult to envision that tax reform this time around can be insulated from the need for increased revenues as part of the overall approach to addressing the deficit.

Our current and out-going Chair, Charlie Egerton, has identified tax reform as a critical area for the Section. Earlier this year, Charlie asked all the committees of the Section to prepare proposals for tax reform in the areas of their jurisdiction. That process is well underway and the committees have responded with a wide range of proposals. This project is one of the largest undertaken by the Section in many years. Charlie will continue to take the lead in this effort after his term as Chair ends in August. Many thanks to Charlie for his leadership on this and other matters over the past year!

Looking forward to the coming year, one of my initiatives will be the creation of a long-term planning task force to assess various aspects of the Section and to make recommendations for improvement. A similar undertaking took place in the late 1990s, under Stef Tucker's leadership, and many recommendations coming out of that effort have been implemented. Given the many developments over the past ten-plus years—in the way we practice law, in telecommunications, the internet, etc.—it is time to take another look at where we are and where we should be heading. If you have any suggestions, including how the Section could better serve you and other members, please send me a note at wpaul@cov.com.

The Section is fortunate (as am I) to have a group of Vice-Chairs for the coming year who are energetic and committed to furthering the interests of the Section and its members. Bill Caudill, the incoming Vice-Chair Professional Services, will be primarily responsible for the Section's CLE portfolio. He takes over for Emily Parker, who will switch to Vice-Chair Government Relations, where her prior experience as Deputy Chief Counsel at IRS should stand her in good stead. Doug Mancino and Fred Witt will

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continue as Vice-Chair Publications and Vice-Chair Administration, respectively, and John Barrie will continue in his role as Vice-Chair Communications. Last, but by no means least, Kathy Keneally will continue in the demanding role of Vice-Chair Committee Operations. As I am often reminded, the Tax Section is a volunteer organization and its viability and success depend heavily on individuals, like Bill, Emily, Doug, Fred, John, and Kathy, who are willing to devote substantial time to Section activities notwithstanding the demands of their day jobs. My thanks to them, as well as to all the Committee Chairs and Vice-Chairs, for their continuing efforts on the Section's behalf.

I would be remiss if I did not also acknowledge the incredible contributions made by the Section's staff. Our executive director, Christine Brunswick, plays a central role in the Section's activities. She and her talented staff make it possible for the Section to function smoothly, even though their on-going contributions are typically behind-the-scenes and largely invisible to Section members. The range of services and support they provide is truly broad—from orchestrating the arrangements for our meetings and teleconferences, to producing the Section's publications, to coordinating the Section's pro bono effort, to dealing with the "Big ABA."

I look forward to the year ahead. ■

To the Editor

June 2, 2011

The interview with Grover Norquist, president of Americans for Tax Reform (Spring 2011), badly mischaracterized how close Congress came in 2006, when I was chairman of the Senate Finance Committee, to enacting legislation to switch to a territorial corporate income tax system.

The ABA interviewers asked Mr. Norquist about prospects for enacting territoriality. Mr. Norquist responded that the then-chairman of the House of Representatives Ways and Means Committee, Bill Thomas, was close to enacting such legislation as his parting successful tax code change. He further asserted that Mr. Thomas would have succeeded, had I not blocked it because I did not understand it. The interviewers did not ask what would have been a logical follow-up question: To what bill was Mr. Norquist referring?

Since the interviewers did not ask the question, I feel compelled to answer it. As then-chairman of the Finance Committee, with exclusive jurisdiction over tax policy in the Senate, I would have known about any bills or even outlines of bills to switch to a territorial system at that time in either the House or the Senate. There were no major bills or proposals, and if there were draft bills in the works, they did not reach the level of committee consideration. In the absence of such bills or proposals, it's not clear how Congress could have come close to enacting such reforms over that period.

Obviously, it would have been difficult for such legislation to advance without notice. Corporate tax reform is highly desired and closely watched. A switch to a territorial system would have been significant and drawn a considerable amount of scrutiny from the affected companies and the media and, I hope, due diligence from Congress in implementing a major shift in corporate taxation. Such a switch would have been, and still would be, complex and require detailed work on several critical design issues. Even now, five years from 2006, the Ways and Means and Senate Finance Committees are holding lengthy hearings to study tax reform, including territoriality. Maybe the switch will happen sometime, but I didn't block something that didn't exist in 2006.

Sincerely,

Chuck Grassley
United States Senate

Editor's Note: Sen. Grassley is former chairman and ranking member of the Finance Committee and current ranking member of the Judiciary Committee.

INTERVIEW

Kees van Raad

By Jasper L. Cummings, Jr. and Alan J.J. Swirski*

Kees van Raad is Director of the International Tax Center Leiden (ITC) at Leiden University, in The Netherlands. Leiden is a beautiful, small, and historic town located between Amsterdam and The Hague, not far from the North Sea. It is famous for its university, founded in 1575, and its tradition of intellectual and religious freedom. The International Tax Center sits in the very heart of Leiden, in its own building at Rapenburg 65, on one of Leiden's many canals.

Q Tell us about your career from out of school forward.

A I graduated in 1969 from Leiden and was awarded a scholarship by the Washington, D.C. Chapter of the Netherlands-American Foundation to attend the LL.M. program at Georgetown University. I was here in Washington, D.C. from 1969 to 1970. I came by boat, which at that time was much less expensive than flying, and the crossing took ten days. I brought my bicycle with me and got around Washington in typical Dutch fashion, by bike. I felt that I was treated like visiting royalty, but I later realized that this was simply American hospitality. I was invited to dinner by the scholarship families, invited to their homes, and given a taste of American culture and traditions. It was a wonderful experience, something that I will never forget, and something that we also try to incorporate in our ITC program. Of course, the spring of 1970 was a turbulent time in America and in Washington in particular. Following the shootings at Kent State in May, students were protesting, our exams were cancelled and the whole city was closed. It was quite an eye-opening experience for a student from Holland.

I returned to Holland in 1970 and began working for the Ministry of Finance, mostly in the international area. From 1975 to 1986, in addition to working at the Ministry, I also taught at Leiden University, and in 1986, I received my Chair in Leiden. I think this was the first Chair in the world just for international tax law, and I was delighted to be in it. For the next 12 years, from 1986 to 1998, I taught international tax law in Leiden full time, except for one day a week which I spent practicing tax law at the firm of Loyens & Loeff in Amsterdam. I am still "of counsel" to the Loyens & Loeff firm, and while I love teaching, I think it is indispensable for tax professors, particularly in international tax, to also be involved in "real world" work. Otherwise, they risk losing touch with what's really going on in the profession.

In 1998, I started the International Tax Center at Leiden, which offers a specialized Advanced LL.M. program for international tax students. I thoroughly enjoy teaching the international students in the ITC program—they really make me feel I should have started the program much earlier! In Leiden, I do not teach undergraduates anymore and teach just at the ITC. In addition, I do a lot of travelling to teach focused international tax law courses, such as the courses on tax treaties and EU tax law that I taught this semester at Georgetown Law (where the interview took place). Every year, I'm in Latin America for some two weeks and in China and in Singapore to teach international tax summer courses.

A collateral effect of my teaching in various countries is that the word spreads about our program at the ITC and students want to come to Leiden for more courses in international tax. We offer the full 12-month Advanced LL.M. program in international tax law, but we also offer a two-week summer course during July for practitioners. In addition, any of the modules of the Advanced LL.M. program can be taken separately, and these range in length from 2 to 12 weeks per module.

Q Tell us about your teaching here at Georgetown as a visitor and compare the U.S. students with your Leiden students.

A I have taught a number of times at NYU, Hastings, Emory and the University of Florida and now at Georgetown, and remarkably, the students who take my courses in the U.S. are largely foreign students. So the students I've taught here are not all that different from the students I have at the ITC.

Q Tell us the origin and history of the ITC.

A By 1995, I had taught many times in the United States and in other foreign countries, and I felt that we in Leiden should make better use of our specialty in international tax. In all of Holland we have about 400 law students a year choosing to specialize in tax at our law schools, so tax is very popular. Four hundred tax lawyers per year for a small country is a lot of tax lawyers, and most of these tax lawyers end up in international tax. So I thought we should capitalize on our expertise and offer in Leiden a post graduate program in international tax.

I taught at NYU for the first time in 1992, and that experience inspired me to start thinking about an international tax LL.M. for Leiden. I talked to two Leiden law deans in a row about setting up an LL.M. in international tax and they both

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said "great plan," and then they said "it is never going to fly financially." Having been told that a few times, I felt could we do it differently. In the end, we set up a foundation that takes all the losses and the profits, and that was how ITC got started. We spent a few years in the red, and then many more years in the black. Now the ITC is solidly in the black.

Q How many students are in the ITC today?

A For the advanced LL.M. program, I aim to have 40 students per year, simply because from experience I know I can remember the names of 40 people. The very personal nature of the Leiden program and the commitment it demands from both the students and the faculty is one feature that sets it apart from other graduate tax programs. If you'd like to hear about our program from a student's perspective, you can read the impressions of one of our alumni, Giusy Bochicchio, posted on the Master of Advanced Studies in International Tax Law section of our website, www.itc-leiden.nl.

Our students work incredibly hard. We encourage them to work in groups so that they learn from each other as well as from our professors. They work hard, but they also celebrate together, everything from the World Cup to the Eurovision Song Contest, plus everyone's birthday to boot (birthdays are a big thing in the Netherlands). We have already had about a dozen marriages of couples who met at the ITC. We offer something of an incentive there, because according to ITC tradition, the children of ITC marriages are entitled to free tuition at the ITC, should they too decide to follow in their parents' footsteps with a career in international tax. We are in our thirteenth year of operation and, as we do not teach Baby Tax in our program, no one has been able to take advantage of this offer just yet.

Q How many people a year apply to join the program?

A Well over a hundred, and it is a difficult process to select the students since they come from so many countries. It is the same problem all over the world with international programs: how can you compare applicants coming from different educational systems and different legal traditions, all of whom will have to study and take exams in English. We use the usual sources to rate universities and so on, but increasingly we rely on our alumni network. We have about 400 alumni now, all over the world, whom we can call for input. We may ask a candidate to meet with one of our alumni for a face to face chat. In addition, we may arrange a Skype interview with the candidate. In this way, we manage, I think, to be quite successful in really making the right choices and ending up with students from diverse backgrounds who are all highly qualified and are capable of doing well in this program.

Q Do most people come straight out of a prior law program or out of the work force?

A Well, ideally our students will have had at least three years of professional experience, but students can also enter the program right out of law school if they so desire. I think the benefit they receive might be greater if they come with some experience, but we have also had some very successful students attend our program directly after receiving their first degree.

Q How long is the program? One year?

A The program is 12 months—I want to make the point of saying 12 months because many programs are nominally a year, but effectively they are only eight to nine months, and the Leiden program is really 12 months. We start at the end of August, and we finish at the end of August, and the students have two weeks off at Christmas and one at Easter. The closing lecture for the graduating class is also the opening lecture for the new incoming class. So we have an intensive 12-month academic program. Our students take advantage of being in Holland while they are at the ITC, and we also organize some outings to show them the best of the Netherlands and its traditions. In the end, they love having worked so hard and achieved so much—you do not have to be a masochist to enjoy this year, but it is very much "work hard, play hard."

Q Where do they usually work after graduation?

A Quite a few students stay in Europe for a while before they go back—if they go back at all. But many of them do go home in the end. In Holland, we have, of course, a Dutch tax code and Dutch case law, and everything is written in Dutch. So it is not easy to work in Holland without knowing something of the local tax law and the language, but it does happen. Most people, though, will end up either working at their country's desk with a Dutch law firm or doing transfer pricing, which is more or less universal. Or they work in Brussels or in London or in Luxembourg, where there are many more opportunities for English-speaking international tax lawyers. At the ITC, we offer job placement services and we hold in early spring a Job Fair where firms visit and interview students "on campus." There are opportunities for international tax specialists in Europe, and many students, I think 25% to 35%, will end up staying in Europe, either for an internship or at a permanent position.

One thing that never seems to be lacking at the ITC is a desire to make the most of the year-long experience. The tuition fee at the ITC is currently €18,000—a lot of money, maybe not by U.S. standards, but a lot of money for people from the Far East or from Latin America. One may wonder why a student would come to Holland from, for example, Peru—there is maybe a professional reason, maybe a personal reason, but there always is a reason. A student is sometimes at a turning point in his or her professional life, maybe also in his or her personal life. Many graduating students have remarked at their graduation dinner that their year at the ITC was a life-changing experience, both in a professional and personal sense.

Q Do any of your students end up in the United States?

A Yes, especially our Latin American students. With the broad international tax knowledge they acquired at the ITC, they are sometimes sent to work in the U.S. by their local office of one of the big four accounting firms. Quite a few end up in New York.

Q What else can you tell us about the program of study?

A I've already mentioned that the program is very demanding, but having said that, I rarely hear our students in Leiden complaining that they are overworked. The 12-month program consists of 9 required modules which are listed on the ITC website, www.itc-leiden.nl, under the Master of Advanced Studies in International Tax Law. All of the courses follow in sequential order. With one exception, there is no choice in the modules, all are required. The only option is one four-week module, in which the students may elect to follow U.S. domestic tax law (individual and corporate) or value added tax. At the end of each module, there is an exam (and some long modules include an interim exam). As a result, our students are examined throughout the year, which is quite different from the way it is in most countries, where there are exams only at the end of the term.

Our first module is a Fundamentals course, and then we move on to the second module, Tax Treaties, that continues for 12 weeks, with 200 hours of class. I do not think there are many other universities where students study tax treaties in such detail! By the time the Christmas holiday rolls around, our students are truly ready for a break.

A special feature of this program is our teaching assistants. I try to arrange that five of the top-ranking students stay on after graduation in August, at least until Christmas. They become my teaching assistants and they help out by giving workshops and tutorials for the incoming students. The new students come from a variety of backgrounds, and those from countries where income tax law is quite simple may need some extra support at the beginning of the program. We have to make sure that during those first few months, everyone in the class arrives at the same level. Working as a teaching assistant is considered to be a great honor, comparable to serving on the law review, offering opportunities to work with top European practitioners and professors who teach at the ITC, so it is a "win-win" situation for both the teaching assistants and the new class of students.

Q Have U.S. students attended the center?

A Yes, occasionally—but we would like to have more and think that we need to spread the message about the ITC and its unique program more widely in the U.S. Typically, about 25% of our students come from Asia, that is the Far East, Indonesia, India, Pakistan, and occasionally countries like Kazakhstan. Another 25% come from southern Europe (Portugal, Spain, Italy, Greece, Malta, and Cyprus), and another 25% come from Latin America. The remainder come from Eastern Europe and Scandinavia, and occasionally from France, Germany, and England, and from the United States, Canada, and Africa.

A fundamental difference between a U.S. international tax program and the ITC Leiden program is that in the U.S., over half of the curriculum deals with U.S. international tax law. At the ITC, there is much greater emphasis on what you may call "international" international tax law, rather than any particular country's international tax law. We do, however, have a U.S. tax law module in the program, simply because international tax lawyers will likely be dealing with the United States in one way or another in their practices.

Q In the U.S., substantial changes to the system of taxing worldwide income and the subpart F regime are being debated. What are your thoughts about changes that might be desirable for the U.S. tax system from a European perspective?

A Well, one important thing is that you do not yet have a value added tax in the U.S. I think it is becoming clearer by the day that eventually the U.S. will have to introduce a (federal) value added tax system. There are interesting questions about how it will work. I would think that you cannot have a (state) sales tax system along with a value added tax system because the value added tax burden is eventually borne by the consumer, so you probably need to consider eliminating sales taxes and implementing VAT revenue sharing with the states, which involves coordination between the federal and state governments.

Second, how equitable can an income tax system be today? I mean, corporate income taxes in particular are so extremely complex virtually everywhere. In the 1960s, when I was a student in Leiden, our corporate income tax code was about 12 printed pages in length. And it has expanded now to about 100 pages, which is still peanuts compared with the United States Internal Revenue Code. And that does not count your volumes of regulations, which we do not have in such a number and detail. Apart from its length, the U.S. federal tax code has become complex because it is used as an instrument for implementing political agendas. I think, in the long run, the question is whether the corporate income tax system will survive, when you know that from an economic perspective, it is eventually the consumer who will pay a large chunk of what is paid in the form of corporate income tax. More likely consumption taxes, in the end, will be the main surviving type of taxes, in addition to taxes levied at the business level on payroll expenditure. I am fairly convinced that some decades from now, income taxes will no longer exist at their current level. A lot of overcomplexity will be gone. In short, the tax landscape may change quite dramatically over the next few decades. ■

OPINION POINT

Are Criminal Fines "Collected Proceeds"?

By Erica L. Brady*

A whistleblower who puts him or herself at risk to provide the Service with information about tax evasion should be paid an award under section 7623(b) based on all of the proceeds collected, including the criminal fines collected. However, the Service has taken the position that whistleblower awards should not be paid on criminal fines. The language of section 7623 expressly refers to criminal prosecutions as one of the actions that can result in payment of an award. Although the Service acknowledges that criminal prosecutions are expressly included as one of the actions that can result in an award, it chooses to ignore this part of the statute. The Service's position, articulated in PMTA 2010-60, Criminal Fines and Whistleblower Awards, and Internal Revenue Manual (IRM) 25.2.2.12, is that collected proceeds exclude criminal fines. Even though the language of section 7623 does not define the limits of collected proceeds, criminal fines are logically included in collected proceeds.

Section 7623(b)(1) states that a whistleblower shall receive a percentage, within the statutorily defined range, "of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from" the administrative or judicial action described in section 7623(a) in response to information provided by the whistleblower. The actions referred to in section 7623(a) are "(1) detecting underpayments of tax, or (2) detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws …." The statute expressly refers to criminal prosecutions as one of the actions that can result in payment of an award. Criminal fines are therefore logically within the definition of collected proceeds.

The language of the statute specifying what is included in collected proceeds is exemplary, rather than an exclusive list. Section 7623(b)(1) prefaces the list of monies included in collected proceeds with the term "including," which "when used in a definition contained in [Title 26] shall not be deemed to exclude other things otherwise within the meaning of the term defined," according to section 7701(c). Therefore, the list included in section 7623 should not be treated as an exhaustive list of the types of monies that make up collected proceeds. Rather, these are examples of types of monies that are included in collected proceeds. Moreover, the plain and ordinary meaning of "additional amounts" is amounts not otherwise listed, which reasonably includes criminal fines.

Although the Service acknowledges that criminal prosecutions are expressly included as one of the actions that can result in an award, it chooses to ignore this part of the statute.

It is logical to conclude that Congress intended to include criminal fines in collected proceeds because at the time Congress enacted the enhanced award provisions, the Service included criminal fines in collected proceeds. The current Treasury regulations and other guidance that remains in effect evidence the Service's long-standing policy of including criminal fines. The current regulations—specifically section 301.7623-1(c), which was enacted prior to the change in the statute—expressly include fines in the types of monies collected that are used to pay an award. That section currently states, in part, "[p]ayment of a reward will be made as promptly as the circumstances of the case permit, but not until the taxes, penalties, or fines involved have been collected." In light of the guidance existing at the time of the enactment, which includes criminal fines in the definition of "collected proceeds," if Congress intended to exclude criminal fines from collected proceeds, it would have expressly done so.

The Service consistently included criminal fines in collected proceeds when it issued guidance and in contracts with whistleblowers. For example, IRS Policy Statement 4-27 provides:

1. Rewards determined by value of information furnished and Computation and payment of rewards
2. The Internal Revenue Service will pay claims for reward applied for on Form 211 commensurately with the value of the information furnished voluntarily and upon the informant's own initiative with respect to taxes, fines, and penalties (but not interest) the Service collects. …

IRM 1.2.13.1.12 (Approved Aug. 13, 2004). Additionally, Publication 733, *Rewards for Information Provided by Individuals to the Internal Revenue Service* (Obsoleted June 19, 2008), and the standard contract with whistleblowers included taxes, fines, and penalties (but not interest) in collected proceeds. The 2006 Treasury Inspector General for Tax Administration Report, *The Informants' Rewards Program Needs More Centralized Management*

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Oversight (2006-30-092, June 2006), states that "[t]he dollar amount of the reward is computed by multiplying the reward percentage by the amount of taxes, fines, and penalties (but not interest) collected." The Joint Committee on Taxation staff's technical explanation of H.R. 6408, The Tax Relief and Health Care Act of 2006, as introduced in the House on December 7, 2006 (JCX-50-06, Dec. 7, 2006), states that the law in effect at that time was that "[a]mounts are paid on a percentage of tax, fines, and penalties (but not interest) actually collected based on the information provided." JCX-50-06, at 88.

Nevertheless, the Service simply dismisses the idea that criminal fines can be considered part of collected proceeds in PMTA 2010-60 "because the IRS does not collect fines imposed by a court in connection with a criminal prosecution, [the Service does] not think that these fines can be considered 'collected proceeds.'" It should be noted that there is no statutory requirement that the Service collect the monies for inclusion in collected proceeds. The PMTA goes on to reason that criminal fines are excluded from collected proceeds because criminal fines that are collected for offenses against the United States are required to be deposited into the Crime Victims Fund under 42 U.S.C. section 10601, unless statutorily exempted. The PMTA acknowledges that criminal prosecutions can result in payment of an award, but disingenuously concludes that the Victims of Crimes Act of 1984 and section 7623 "can easily be read harmoniously, giving full effect to Congressional intent for both statutes."

When a whistleblower has provided information that led to a conviction, the Victims of Crimes Act and section 7623(b) cannot be read harmoniously because each statute mandates that the monies collected be used in different ways. The Victims of Crimes Act mandates that criminal fines be deposited into the Crime Victims Fund, while section 7623(b) requires that the Secretary pay a percentage of the collected proceeds to the informant if the statutory requirements have been met. Where two statutes are in conflict, the one enacted most recently generally prevails, as it is the latest expression of legislative intent. *Blue Cross and Blue Shield of Alabama, Inc. v. Nielsen*, 116 F.3d 1406, 1410 (11th Cir. 1997); *see also* 73 Am. Jur. 2d Statutes § 169. The Service nevertheless concluded that due to the detailed exceptions provided in 42 U.S.C. section 10601, the award mandate of section 7623(b) should not act as an implied exception even though section 7623(b) is the later enacted statute. There was no conflict in the statutes prior to the enactment of the enhanced award provisions because awards were discretionary. The conflict in the law arose when Congress enacted the enhanced award provisions in 2006. Therefore, the criminal fines collected should be included in collected proceeds, and the balance of these criminal fines, after the award is paid, should be deposited into the Crime Victims Fund.

Moreover, PMTA 2010-60 claims, "a court has no authority to order such a payment because to do so would nullify Congress' authority under the Appropriations Clause of the Constitution." This statement is clearly false. If a court finds that criminal fines are, in fact, part of collected proceeds, then it may order an award to be paid from the criminal fines—without running afoul of the Appropriations Clause—because section 7623(b) mandates payment of an award from collected proceeds where certain statutory requirements are met. The court would not be ordering a payment for which there is no authority; rather the court would be interpreting the scope of what is properly included in collected proceeds under section 7623(b) and ordering a payment in accordance with its interpretation of the statute.

Congress intended to strengthen the whistleblower program by increasing incentives for whistleblowers to come forward. To that end, Congress expanded the pool of collected proceeds that formed the basis of an award by including interest in collected proceeds. If criminal fines are not included in the definition of collected proceeds, the pool of collected proceeds from which awards can be paid will contract, reducing the incentive available to entice whistleblowers to come forward, making it less likely the Service will receive information regarding the most egregious violations of internal revenue laws. ■

N. Jerold "Jerry" Cohen—2011 Distinguished Service Award Recipient

By Stanley L. Blend*

The Section of Taxation honors N. Jerold "Jerry" Cohen as the 2011 recipient of its **Distinguished Service Award** in recognition of his outstanding career and contributions to the tax profession, the Section, and the government.

Before discussing Jerry's commitment as a lawyer and tax professional, first some personal notes about Jerry the father and husband. Jerry was born in Pine Bluff, Arkansas, on June 13, 1935. Jerry attended Tulane University and received his B.B.A. in 1957. Jerry then attended Harvard Law School and received his LL.B. magna cum laude in 1961. While at Harvard, he served as the book review editor of the *Harvard Law Review*. Jerry's friend, David Glickman, says Jerry is one of many outstanding tax lawyers that came out of the 1961 class at Harvard Law School, among them Jack Levin, Danny Halperin, and Jere McGaffey.

Jerry is a devoted husband, father, and grandfather. Two of his children, Pam Torres and Giles Cohen, are lawyers. His other son, Lindsey, is a child psychologist and professor at Georgia State University. Jerry is devoted to his grandchildren, Sophie, Liam, Avery, Phoebe, Noah, and Liv. Many may know Jerry as a tough negotiator when he is representing a client on a tax matter, but Jerry's grandchildren know that the favorite part of their visit to Chez Cohen is a visit to the "treat closet." Grandpa Jerry keeps it well stocked and insists that the grandchildren visit the "treat closet" on each visit to Chez Cohen.

Jerry is a man of routine. He exercises first thing in the morning and never misses a day of work on Saturday. When Jerry was courting his wife, Andrea, a date was often a trip to the gym, followed by a work date at the office. Jerry and Andrea were married on Labor Day, which evidenced how hard she worked to get him to the altar, because marriage would mean time off for a honeymoon. Jerry's friends and acquaintances all agree that Jerry's marriage to Andrea was a life-changing experience.

He was appointed by President Carter to serve as Chief Counsel for the Internal Revenue Service in November, 1979, and served until January, 1981. In recognition of his service, he was presented the Commissioner's Award for outstanding service to the Internal Revenue Service and the General Counsel of the Treasury's Award for outstanding service to the Treasury Department.

Jerry's commitment to community is exemplary. He has served as president of the ACLU of Georgia, and as a member of the National ACLU Board. He has also served as chair of the Metropolitan Atlanta Community Relations Commission. He has been a member of the Board of the Atlanta Lawyers Committee for Civil Rights Under the Law. He has also served as an advisor to the Metropolitan Atlanta Housing Coalition, and is a Board member of the Southern Exposure. Jerry litigated a free speech case for the *New York Times* and litigated voting discrepancy cases for Maynard Jackson and Andrew Young. Jerry also litigated a number of other cases for the ACLU.

As a tax professional, Jerry's accomplishments are second to none. Jerry has been active in the ABA for over 40 years. He is a past chair of the Section of Taxation, having served from 1995-1996, prior to which he served as a Section vice-chair and member of Council and as chair of the Formation of Tax Policy and Corporate Stockholder Relations Committees. His involvement in the ABA extends beyond the Tax Section having also served as a past chair of the Taxation Committee of the Litigation Section. He also has served as chair and as a member of the Board of Regents of the American College of Tax Counsel and as a Board member of the American Tax Policy Institute. Jerry is also a member of the American Law Institute and its Tax Advisory Board.

Jerry has served as a member of the Board of Advisors of the *Virginia Tax Review*, is a former member of the Advisory Council of the Internal Revenue Service, a former member of the Board of Advisors of the Internal Revenue Service's Continuing Professional Education Program, a former member of the Advisory Group to the staff of the Senate Finance Committee on the

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Subchapter S Revision Act, and has served on the Advisory Boards of both Little, Brown and CCH. Jerry is also a former adjunct Professor of Law at Emory University.

Jerry's commitment to public service is noteworthy. He was appointed by President Carter to serve as Chief Counsel for the Internal Revenue Service in November, 1979, and served until January, 1981. In recognition of his service, he was presented the Commissioner's Award for outstanding service to the Internal Revenue Service and the General Counsel of the Treasury's Award for outstanding service to the Treasury Department. Jerry has lectured at numerous tax programs, including the New York University Institute on Federal Taxation, University of Miami Tax Conference, University of Virginia Conference on Federal Taxation, Southern Federal Tax Institute, American Tax Institute, Hawaii Tax Institute, Tulane Tax Institute, and many others. Jerry has also written extensively and published in numerous tax periodicals. Recently, Jerry was one of the speakers at the Tax Analysts Roundtable on Tax Shelters and Penalties. Jerry co-chaired New York University's Second Annual Tax Controversy Forum in June, 2010.

Jerry's expertise in the area of tax is well recognized within the tax community. He has served as an arbiter and a mediator in tax disputes, and as a tax expert in cases involving marital disputes, stock buy-outs, negligence claims, newspapers, and others. The best way to understand the esteem in which Jerry is held within the tax and legal community is by reference to comments made about Jerry by his friends and peers and by his partners at Sutherland Asbill & Brennan LLP. His friend, Ron Pearlman, the 2010 Distinguished Service Award Recipient, says that Jerry is an "extraordinarily warm and genuinely friendly individual." Ron further states that, "Jerry is indeed a superb lawyer. His intellectual ability is exceptional. Jerry materially contributed to the Office of the Chief Counsel bringing to it his extensive private practice experience. At the same time, his experience in the Government helped Jerry to understand the purpose of tax policy and broadened his perception of the tax system." Ron says that Jerry's only failing is that he "works too hard, notwithstanding the fact that Andrea has successfully gotten him out of the office occasionally."

"Jerry's tax intellect is only exceeded by his generosity in mentoring young lawyers. He always takes time to aid in the growth in younger partners and associates."

Stef Tucker, another past Chair of the Section of Taxation, states that, "with all due respect to every other tax litigator, in my view, Jerry is the very best tax litigator in this country for major, complex tax matters." Stef adds that Jerry's commitment to community through his tireless efforts on behalf of civil rights says a lot about his character. Perhaps, most important, Stef says that, "there is no one nicer than Jerry. To be redundant, he really cares." David Glickman, past Assistant Secretary of the Treasury for Tax Policy and a former roommate of Jerry's, says that, "Jerry is extraordinarily driven, insisting that the job be done correctly, and that his clients always be well represented. Jerry loves the tax law and finding solutions for his client's problems. There are few in the tax community who are more well-liked than Jerry Cohen. Jerry has the knack to get along in any environment in which he is placed. Jerry has a wonderful sense of humor."

His partners at Sutherland speak of Jerry with the highest praise and regard. Jerry's tax partner Joe DePew states that, "Jerry's tax intellect is only exceeded by his generosity in mentoring young lawyers. He always takes time to aid in the growth in younger partners and associates. Jerry unselfishly spends significant time in the development of these individuals into first-class tax lawyers." Joe further states that, "an example of Jerry's dedication to the practice can be illustrated by his constant desire to stay current on tax issues. When he actually takes vacation, he has his secretary send him the daily tax publications via overnight delivery to whatever far off place he may be, whether that is somewhere in Africa, Australia, or South America." Jerry's partner, Charlie Hurt, refers to Jerry as "the true Renaissance man. He is fully capable of expounding on any subject: art, sports, literature, politics—you name it and he will immediately add to your knowledge. He's a pleasure to practice, travel, and dine with."

Jerry is a fine father, husband, committed tax professional, and community servant. For these reasons, Jerry is the perfect choice of the Section of Taxation's 2011 Distinguished Service Award. ■

2010 Law Student Tax Challenge Bench Briefs

Editor's Note: The Law Student Tax Challenge (LSTC) was established in 2001 by the Young Lawyers Forum. It is an annual inter-law school transactional planning and client counselling competition designed to focus on the tax consequences of a complex business-planning problem. LSTC problem drafters prepare separate problems for J.D. and LL.M. competitors and provide detailed bench briefs for use by judges.

The discussion below condenses the extensive analysis provided in the J.D. and LL.M. problem bench briefs. For the J.D. problem, the discussion omits most of the citations and much of the discussion (in addition to omitting some of the issues). For the LL.M. problem, the discussion omits most of the issues but includes a fuller discussion of selected issues. *NewsQuarterly* invites readers to express their opinions as to which format they prefer to see in future years. *NewsQuarterly* acknowledges the efforts of Katie Crenshaw (LSTC co-chair) and Ivan Golden, Jonathan Grossberg, and Andrew Reiter (problem drafters).

For more information about the 2010 winners and judges, and the 2011 competition announcement and rules, go to www.americanbar.org/groups/taxation. — Gail Levin Richmond, Professor of Law, Nova Southeastern University Law Center, Davie, FL.

J.D. Problem Introduction

The 2010 LSTC problem for the J.D. division focuses on the income tax issues faced by a professional golfer ("Irons"), who became embroiled in scandal. Specifically, the problem asks students to consider: (1) How Irons should structure payments to his wife (Janna) pursuant to their divorce, (2) whether Irons may deduct any of the expenses he incurred on a trip to California to prepare for a golf tournament, (3) the income tax consequences of Irons winning $2 million in a golf tournament, and (4) the income tax consequences of Irons' contemplated investment in bonds. In addition, the problem presents several other issues the students are expected to address. These include promising to pay $10 million in hush-money to a woman (Roslyn) with whom he had an affair—and later compromising with her for $4 million—and paying a $100,000 fine to the professional golf tour (PGT) for conduct unbecoming a tour member. Issues included in the problem but omitted below include a claimed medical expense for treatment of sex addiction, and the tax consequences of winning the $2 million in the tournament and of receiving free meals from potential sponsors.

As a threshold issue, students should note that Irons is a professional golfer. Moreover, Irons' role as a celebrity spokesman also qualifies as a trade or business. Consequently, any expenses paid or incurred with respect to his golf activity or his endorsement activities are potentially deductible under section 162, provided the expense meets the requirements of that section and is not limited by other Code sections.

Payment to Roslyn

The first issue is whether Irons may deduct his $4 million payment to Roslyn. Arguably, the payment is an ordinary and necessary business expense to protect Irons' reputation because his endorsement income would suffer greatly if his affair were discovered. On the other hand, it could be argued the payment was personal in nature and was made to protect his marriage and personal reputation.

Under all of the facts and circumstances, Irons' payment to Roslyn probably is not deductible. Although the payment was appropriate and helpful in that it preserved (or at least was intended to preserve) Irons' reputation for personal integrity, which is crucial to his business of serving as a corporate spokesman, there is no evidence that the payment was ordinary in the life of the group of which Irons is a part. Moreover, it is not clear that the payment was made to protect Irons' business reputation as distinguished from his personal reputation.

Another issue is whether Irons' promise to pay Roslyn $10 million and the parties' subsequent settlement for $4 million gives rise to cancellation of debt (COD) income. However, there are several exceptions to the general rule that a discharge of indebtedness gives rise to COD income, including discharges of a contested liability. In this case, Irons' promise to pay Roslyn $10 million is probably too speculative to be cognizable for tax purposes or was merely an executory promise that did not give rise to a debt or obligation. Accordingly, Irons' subsequent agreement to pay $4 million should not give rise to COD income. Finally, the underlying policy rationale for requiring taxpayers to recognize COD income—*i.e.*, that to the extent a taxpayer is released from debt the taxpayer has an accession to wealth due to the freeing of assets previously subject to a liability—does not exist where, as here, no money has changed hands.

Fine Paid to PGT

Although a fine is rare in the career of any individual athlete—particularly where, as here, the fine is not strictly related to his on-court or on-field performance—it is ordinary in the sense that it is not a capital expenditure and is common in the community of which Irons is a member,

i.e., the PGT. Moreover, payment of the fine is necessary because it is appropriate and helpful. Indeed, by paying the fine, Irons was able to resume his professional golf career without further discipline or disruption. Finally, while it could be argued that the conduct with respect to which the fine was imposed was personal in nature, it is hardly unusual for professional athletes to be fined for off-field misconduct. Accordingly, the $100,000 PGT fine probably is deductible.

Divorce

Property Settlement

Students should discuss the rules regarding nonrecognition of gain or loss (and transferred basis) on transfers of property to (1) a spouse or (2) to a former spouse if the transfer is incident to a divorce. This includes the requirements for a post-divorce transfer being incident to the divorce. The problem facts involve both appreciated property and property that is worth less than its basis. Students are expected to take the relative difference between basis and value into account in advising Irons which properties to transfer.

Alimony and Child Support Payments

Students are expected to discuss the requirements for a payment to qualify as alimony versus nondeductible child support or some other payment. They must also discuss alimony recapture. The problem includes two payment options: both involve payment drops that appear to be child support disguised as alimony. The second also involves potential recapture because the non-child-support payments are made only in the first three years. The bench brief includes a detailed computation of the alimony recapture potential.

Dependency Exemption

Students are expected to discuss the general rules for taking a dependency exemption deduction and the special rules that allow the exemption to be taken by a noncustodial parent.

Travel and Other Expenses

The next issue is whether Irons may deduct all or part of the expenses he incurred traveling to and staying at a California spa to prepare for his return to competitive golf.

Travel Expenses

Traveling expenses, including expenses for meals and lodging that are not extravagant under the circumstances, while traveling away from home in pursuit of a trade or business generally are deductible. However, as noted above, no deduction is allowed for personal, living, and family expenses. Moreover, no deduction is allowed for any traveling expense unless Irons satisfies the substantiation requirements.

If a taxpayer travels to a destination and while at the destination engages in both business and personal recreation, traveling expenses to and from the destination are deductible only if the trip is primarily related to the taxpayer's trade or business. If the trip is primarily personal, traveling expenses to and from the destination are not deductible; expenses at the destination that are properly allocable to the taxpayer's trade or business are deductible.

With respect to Irons' traveling expenses, *i.e.*, the private jet and limousine, the question is whether the trip as a whole qualifies as a business trip. Although Irons' trip to the spa included both business and personal activities, the primary purpose of the trip was for Irons' business, *i.e.*, to prepare for a professional golf tournament and to hold meetings with potential sponsors. Accordingly, Irons' travel costs to and from the spa are deductible, even though five days of his two-week trip were spent largely on personal activities and relaxation. Although it could be argued that a private jet and limousine are extravagant under the circumstances, no court has ever applied that limitation.

Lodging, Meals, and Other Expenses

Although the primary purpose of Irons' trip to the spa was in pursuit of his trade or business, only those expenses that are properly allocable to a taxpayer's trade or business are deductible. Moreover, the amount allowable as a deduction for (1) food or beverages, and (2) any item with respect to an activity generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, is limited to 50% of the amount that would otherwise be deductible.

With respect to the lodging expense, the first week of Irons' trip to the spa was spent training and preparing for a professional golf tournament. Thus, the $1,000-per-night expense should be deductible, provided it is not considered extravagant under the circumstances. One issue concerns whether Irons will be allowed to deduct only one-half of the expense because the spa may be considered a facility used in connection with entertainment, amusement, or recreation.

Likewise, Irons' payments to the swing coach and trainer are deductible because they are ordinary and necessary in his trade or business. Irons' status as a professional golfer is crucial in this context. Finally, 50% of Irons' expenses for meals while at the spa are deductible, subject to the substantiation requirements.

The first two days of the second week of Irons' trip were spent meeting with potential sponsors. As noted above, Irons' activities as a corporate spokesman likely qualify as a second trade or business or, alternatively, an activity engaged in for profit. Thus, Irons' lodging for the second two nights of the trip also is deductible subject to the substantiation requirements. Irons' last five days at the spa were primarily for pleasure and recreation; none of the expenses he incurred are deductible.

Clothing and Equipment

The golf wardrobe, shoes, and golf clubs Irons purchased raise further issues with respect to deductible expenses. Clothing is deductible if it is:

(1) required for the job, (2) not adaptable to general usage, and (3) not so worn. Clothes typically referred to as "golf shirts" are worn by ordinary individuals on a daily basis. Furthermore, pants worn by golfers are easily adaptable to daily use. Thus, it seems probable that the wardrobe is suitable for daily use.

With respect to the golf clubs and shoes, the issue is whether the cost of acquiring the property is currently deductible as an ordinary and necessary business expense or is instead a capital expenditure that is not currently deductible. The determination of whether an expense is currently deductible or must be capitalized is not a straightforward or mechanical process; the determination depends on the facts and circumstances of each case. Expenses must generally be capitalized when they either (1) create or enhance a separate and distinct asset, or (2) generate significant benefits that extend beyond the end of the taxable year.

It is doubtful that the golf shoes have a useful life that extends substantially beyond the taxable year. With respect to the golf clubs, it is a closer question. Accordingly, the cost of acquiring the clubs probably is best characterized as a capital expenditure and the cost must be recovered via depreciation. The bench brief includes a detailed discussion of the applicable depreciation rules (method, recovery period, life) and eligibility for section 179.

LMN Bonds

The LMN bonds' unusual payment schedule—no periodic interest payments but a $500,000 premium at redemption—might appear to offer a deferral benefit because the bondholders will not receive any interest payments until 2020. However, the original issue discount (OID) rules generally prevent bondholders from enjoying a deferral benefit. The bench brief includes a detailed discussion of the OID rules and the relevant computations.

LL.M. Problem Introduction

The LSTC problem for the LL.M. division focuses on the income tax issues faced by a wealthy entrepreneur in the energy industry, T. Bone Dickens, who is considering several potential investments. He is a 50% shareholder in Energy Inc. along with Green Source Private Equity ("Green Source"), a private equity firm that focuses on green energy investments. Energy Inc. is an energy company that operates four different energy production businesses: solar panel manufacturing, wind farms, geothermal, and a single oil rig off the coast of Houston. The solar panel, wind farms, and geothermal businesses, Solar Inc., Wind Inc. and Geo Inc., respectively, are all directly owned by Energy Inc., and the oil rig business is operated as a branch of Geo Inc. Energy Inc., Solar Inc., Wind Inc. and Geo Inc. (collectively the "Energy Group") file a consolidated return. T. Bone also owns and operates a successful natural gas business. The problem includes detailed information about these companies' assets and operations.

Specifically, the problem asks students to consider: (1) How T. Bone should structure a split-off transaction to minimize tax consequences, (2) with which investors T. Bone should form an S Corporation, (3) what can the S corporation do to maximize T. Bone's ability to take losses, and (4) what sort of reorganization structure should T. Bone suggest so as to maximize return and minimize tax consequences in his attempt to acquire a corporation or the assets of a corporation. In some instances, the proper resolution of an issue is not entirely clear, either because the law is in flux or because the facts of the problem are purposefully ambiguous.

Structuring the Split-Off Transaction

Choice of Transactions

Energy Inc. and T. Bone have two options as to how to transfer the oil rig assets to T. Bone in exchange for his stock in Energy, Inc:

Option 1—Cause Geo Inc. to distribute the assets to Energy Inc. followed by a redemption of T. Bone's stock in exchange for the oil rig assets. Generally, because Geo Inc. and Energy Inc. are within the same consolidated group, the initial distribution to Energy Inc. should not trigger current taxation. The exchange of the oil rig assets for T. Bone's stock, however, should be a taxable event. Section 317(b) provides that where a corporation acquires its stock from a shareholder in exchange for property, such a transaction should be considered a redemption. As the transaction is a redemption, a section 302 analysis is required. T. Bone will be redeeming all of his shares in Energy Inc. Section 302(b)(3) provides that section 302(a) will apply where a redemption is in complete redemption of all the shareholder's stock in the corporation, and under section 302(a) such a redemption will be treated as a distribution in exchange for the stock and taxable as such under section 1001. Because the FMV of T. Bone's stock exceeds his adjusted basis in the stock, there should be gain recognized on such an exchange.

Option 2—Cause Geo Inc. to contribute the oil rig assets in the formation of a new corporation, which can then be spun off twice—once to Energy Inc. and then again to T. Bone. Students should realize that they cannot simply spin-off Geo Inc. as it also operates a geothermal business that is remaining within the Energy Group. However, the final instructions to the students may confuse this issue. The students were instructed to discuss the following: "How should the deal between Energy Inc. and T. Bone be structured to

minimize tax consequences to our client when he acquires Geo Inc.?" It may have been clearer to say ". . . when he acquires *the oil rig business*?" The difference between these two possible answers is that the formation/spin-off could be considered a (D) reorganization under section 368 and the pure spin-off of Geo Inc. will simply be analyzed under section 355. That is to say, if students just spin-off Geo Inc., they would be missing the analysis of the (D) reorganization aspects.

After analyzing these options, students should be able to conclude that, while the second option is not tax free, it offers significantly less tax liability than the first option.

Analysis of the (D) Reorganization and Section 355

Section 368(a)(1)(D) provides that a transfer by a corporation of all or a part of its assets to another corporation where, immediately after the transfer, the transferor or one or more of its shareholders is in control of the corporation to which the assets were transferred will be treated as a reorganization if, pursuant to a plan, stock or securities of the transferee corporation are distributed in a transaction to which section 355 applies. As described in Option 2, the first step would be for Geo Inc. to contribute the oil rig business assets to a newly formed corporation, SpinCo, and distribute the shares of SpinCo to Energy Inc. This transaction should satisfy the first part of section 368(a)(1)(D) as Energy Inc., a shareholder of Geo Inc., will own 100% of the stock, and thus be in control within the meaning of section 368(c), of the company to which the assets were transferred, SpinCo.

Section 368(a)(1)(D) also requires that the transaction qualify under section 355. A transaction meets the requirements of section 355 if (1) the corporation distributes to a shareholder, with respect to its stock, solely stock of a corporation which it controls immediately before the distribution; (2) the distributing corporation distributes all or at least 80% of the stock in the controlled corporation held immediately before the transaction; (3) the active business test is met; and (4) the transaction was not used principally as a device. As described above, Geo Inc. will form SpinCo and distribute all of SpinCo's stock to its sole shareholder Energy Inc.; thus Geo Inc. will distribute to its shareholder, with respect to its stock, all the stock in SpinCo, which Geo Inc. controlled immediately before the distribution, and satisfy the first two requirements under section 355(a). The active business test requires that both the distributing corporation and the controlled corporation be engaged immediately after the distribution in the active conduct of a trade or business. For purposes of the active business test, a corporation will be treated as engaged in an active trade or business if and only if, (1) it is engaged in the active conduct of a trade or business, (2) such trade or business has been actively conducted throughout the five-year period ending on the date of the distribution, (3) such trade or business was not acquired within that five-year period in a transaction in which gain or loss was recognized, and (4) control of a corporation which was conducting such trade or business was not acquired in a taxable transaction within the five-year period. While the facts provide that the oil rig business has been conducted since T. Bone contributed Geo Inc. to Energy Inc. five years ago, the proposed transaction would have SpinCo acquire the oil rig business immediately before the spin-off, which would seemingly violate the five-year requirement. However, both control over SpinCo and SpinCo's acquisition of the oil rig business occurred through a transaction where a person, Geo Inc., transferred property to SpinCo solely in exchange for SpinCo stock which resulted in Geo Inc. owning 100% of SpinCo's stock—a transaction that should qualify as a tax free formation under section 351. Because both control over SpinCo and acquisition of the oil rig business occurred in non-taxable transactions, SpinCo should satisfy the active trade or business requirement despite the recent acquisition of the oil rig business.

Under section 355 the transaction must also not be a device for the distribution of Geo Inc.'s earnings and profits. Whether a distribution is considered a device is based upon the facts and circumstances, including the presence of device and non-device factors. Device factors include pro rata distribution, subsequent sale or exchange of the distributed stock, and the nature and use of assets of both the distributing and controlled corporations. According to the proposed transaction, Geo Inc. will distribute the stock of SpinCo to its only shareholder, *i.e.*, a pro rata distribution, which is a factor in favor of a device. The proposed transaction also provides for the exchange of SpinCo's stock immediately after the distribution as part of a pre-arranged plan, which is generally substantial evidence of a device. However, in Rev. Rul. 62-138, the Service held that section 355 will apply to consecutive spin-offs within a corporate chain. Therefore, the fact that Energy Inc. distributes the SpinCo stock to its shareholders in a second section 355 transaction immediately after it received the stock, will not disqualify the first distribution from tax free treatment under section 355, and the post-transaction change should not be treated as evidence of a device.

The nature of the distributing corporations and the controlled corporation's assets could also be evidence of device. If the distributing corporation or the controlled corporation's assets are made up of mostly assets that are unrelated to the conduct of an active trade or business, there is likely evidence of device. In Rev. Rul. 73-44 the Service found that the fact that the distributing corporation's active trade or business assets made up less than half of the

corporation's assets could be evidence of device; however, other non-device factors overcame this factor, and led the Service to find that the distribution was not a device. There are no facts regarding the assets of the distributing corporation; more facts would be needed to determine where there would be evidence of a device with respect to the distributing corporation. The facts do indicate that the controlled corporation has at least $150 million in assets that are not related to the active trade or business (*i.e.*, the cash), making up 11.11% of the corporation's total assets. If the $150 million of unrelated assets exceeds the reasonable needs of the active trade or business, then there would be evidence of device. 11.11% is far less than the more than 50% in Rev. Rul. 73-44 in which the Service still found the transaction not to be a device because the other non-device factors, such as business purpose and a non-pro rata distribution, outweighed the device factor. Therefore, while there may be a device factor arising from the nature of the assets, it is likely that the non-device factors discussed below are more determinative of the outcome.

The device factors described above should be weighed against non-device factors. The valid business purpose, discussed below, can be evidence that the transaction was not a device. A strong business purpose can potentially outweigh the device factor created by non-business assets. The fact that the stock was distributed to a domestic corporation that would qualify for the dividends received deduction for dividends paid by the distributee corporation is a non-device factor. Based on the non-device factors and the business purpose described below, it is likely that the distribution would not be seen as a device.

There are also three non-statutory requirements for the distribution to receive tax free treatment under section 355: business purposes, continuity of interest, and continuity of business enterprise. Section 355 will apply only to those transactions for which there is a corporate business purpose, which is a real and substantial, non-federal tax business purposes of the distributing corporation, the controlled corporation or the affiliated group. According to the facts, both Green Source and T. Bone wish to separate the oil rig business from Energy Inc. Green Source does not wish to have that type of business in a company it owns because it is worried that owning the oil rig business may cause its environmentally conscious investors to leave, and T. Bone no longer wants to be partners with Green Source. However, these business purposes are shareholder business purposes which generally do not qualify as a business purpose for the Energy Group unless the shareholder business purposes are so intertwined with a corporate business purpose that it is not practical to distinguish between them. In our case, Green Source and T. Bone would need to be able to show that their disagreement over the future of Energy Inc. affected the operations of Energy Inc., thus establishing a business purpose for the distribution of the oil rig business.

To meet the continuity of interest requirement, the shareholders of the acquired corporation in the aggregate have to receive stock of the acquiring corporation worth at least 50% of the acquired corporation's stock. There is a rule in the temporary regulations that permits the value of the stock as consideration to be valued as of the date of issue and also permits the consideration to be 40% stock and 60% cash. The continuity of interest should be satisfied because after the distribution Energy Inc. owns a 100% interest in both the distributing and controlled corporations despite the fact the Energy Inc. immediately distributes the stock to T. Bone. Additionally, as T. Bone will be continuing the oil rig business, there is nothing in the facts that would indicate the continuity of business enterprise requirement would not be met.

Based on the discussion above, the first distribution should fall under section 355 and be treated as a type D reorganization under section 368(a)(1)(D).

Tax Consequences of the (D) Reorganization

Generally, no gain or loss is recognized by a corporation that is a party to a reorganization upon a distribution of property to its shareholders as part of the plan of reorganization. Thus, no gain or loss is recognized by Geo Inc. upon the distribution of SpinCo to Energy Inc.

Section 355(a)(1) generally provides that no gain or loss is recognized by the shareholders of the distributing company upon a distribution that qualifies under section 355.

Generally, basis of the stock received in a reorganization is determined under section 358 and equals the basis of the property exchanged for the stock received. However, under Option 2 there is no exchange for SpinCo's stock; it is simply distributed to Energy Inc. Under these circumstances, section 355(c) provides that shares of the distributing corporation which are retained will be treated as surrendered, and received back, in a deemed exchange. In order to determine Energy Inc.'s basis in SpinCo and its new basis in its Geo Inc. stock, the fair market value of Geo Inc. is needed. This, however, was not provided and a calculation of the actual basis cannot be done. ■

PRO BONO MATTERS

Access to Justice for Underserved Taxpayers

By Peter A. Lowy*

Pro bono work is the closest most of us tax nerds will ever come to being a super hero. More on that in a moment. But first, several observations:

First, the tax bar (with contributions from the ABA Tax Section's Pro Bono Committee) is making remarkable progress in building a robust infrastructure for delivering pro bono tax services to individual taxpayers who cannot afford an attorney. We are in the midst of two transformative movements—the Low Income Taxpayer Clinic (LITC) movement and the Tax Court Calendar Call movement.

Before these two programs existed, vehicles for disseminating tax law services on a pro bono basis were largely limited to VITA (Volunteer Income Tax Assistance), which was established by the Internal Revenue Service in 1969. The VITA program focuses on tax return preparation, and thus reaches only a small portion of the tax issues that individuals face and does not utilize many of the rarer legal skills that most tax lawyers possess. With the addition of LITCs and the Tax Court Calendar Call programs in recent years, many more opportunities are available for tax attorneys to apply their talents to help taxpayers on a wide range of tax matters on which legal advice and services are needed but cannot be afforded. These developments are monumental.

Second, while the tax bar has made tremendous progress, it should not be complacent. There is room for improvement. Work remains to be done. For example, the Calendar Call program is still in its infancy, and its expansion will take continued leadership to reach cities that are not currently served and to ensure the quality of the program in each city is adequate.

There also appears to be an opportunity gap for certain transactional lawyers. Tax litigators and those with practices catering to individuals have the Calendar Call program and LITCs; return preparers have VITA. But many talented tax lawyers, particularly in corporate tax practices, may lack a logical application of their skills in the pro bono space. Exempt organization workshops provide opportunities for a slice of this population, and there are other, less developed programs being piloted; but room exists for new solutions to fill this gap.

Third, there are many terrifically talented and motivated professionals contributing to the pro bono movement. Some are well known, such as Karen Hawkins, who has contributed significantly to the Calendar Call movement and is now the OPR director at the Service, and Nina Olson, who similarly has contributed significantly to the LITC movement and is the IRS National Taxpayer Advocate. But there are many others making substantial contributions and equipped to start the next great pro bono movement in the tax area. These dedicated folks deserve appreciation and should be encouraged to keep up the good work.

Fourth, the ABA Tax Section's institutional commitment has played a leading role in furthering pro bono initiatives. While its support of pro bono opportunities for tax lawyers and its involvement in VITA go back over three decades, the Section has dramatically increased its resource allocation to pro bono in more recent years. It established the Pro Bono Committee to provide a sort of think tank for strategies around pro bono services; created the Pro Bono Award to encourage volunteerism; and hired a staff counsel dedicated to the Section's pro bono efforts. It also facilitates LITC and Pro Bono listservs that have become online community think tanks connecting pro bono attorneys across the country. More about what the Section is doing in this area will be featured in future Pro Bono Matters columns in the *NewsQuarterly*.

Collectively, these steps have helped formulate and advance strategic programs that form the core infrastructure for delivering pro bono services in the tax area, enable networks of attorneys to exchange advice in handling low-income taxpayer matters, and encourage tax lawyers to volunteer their time to solve both individual and systemic problems facing underprivileged taxpayers in the United States.

Finally, feeling like a super hero. For many taxpayers, a tax problem is a significant and stressful life event, particularly if they cannot afford a tax professional to explain and guide them out of their predicaments. When a pro bono attorney helps such a person through this life event, the response is typically overwhelming appreciation as if a heroic fete had been accomplished. Clients break down in tears out of relief, invite you to family dinners, put you on their Christmas card list, and display many other gestures of appreciation.

Bottom line: As tax attorneys, we take our skills for granted. Applied in the pro bono context, we can, in the eyes of many underserved taxpayers, truly save the day!

Pete Lowy is the outgoing chair of the Pro Bono Committee and incoming chair of the Court Procedure & Practice Committee. In this column, he shares several observations from his experience chairing the Pro Bono Committee.

—Francine J. Lipman, Professor of Law, Chapman University, Orange, CA

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May Meeting Pro Bono Outreach in Washington, D.C.

On Thursday afternoon on Cinco de Mayo, 2011, at the May meeting in Washington, D.C., super hero volunteers were out in full force. For more than one dozen taxpayers, who were struggling with tax matters as straightforward as under-withholding on wages and as complicated as the intersection of immigration naturalization law issues with incomplete historic tax filings, heroic staff and volunteers from several local organizations joined with the Pro Bono Committee to provide access to justice for underserved taxpayers. **Community Tax Aid, Inc.**, staff and volunteers, including **Teresa Hinze, John Charles ("JC") Craig, Fred Bailey,** and **Gary Spiegel,** as well as **David Sean** (Legend Financial) set up and broke down a full service VITA site to prepare (and when possible efile) more than 20 federal and state tax returns, most of which were challenging prior year returns. In addition, tax attorneys **Erica Brady** (The Ferraro Law Firm), **Shelly Cole** (American University Washington College of Law), **Rachel Ney** (Pro Bono Staff Counsel, ABA Tax Section), and **Francine Lipman** (Chapman University School of Law), working together with the **Taxpayer Advocate Service Office** and **Andrea Rodriguez** (Central American Resource Center), served taxpayers with a myriad of complex tax issues. The **University of the District of Columbia David A. Clarke School of Law Low Income Taxpayer Clinic** (Keith Blair), the **Janet R. Spragens Federal Tax Clinic at American University Washington College of Law** (Shelly Cole), and the local **Taxpayer Advocate Service Office** agreed to work with taxpayers who had issues that could not be resolved that afternoon. The Pro Bono Committee's plan is to repeat this taxpayer outreach program in Washington, D.C. next May, but to do it bigger and better.

Denver Meeting Pro Bono Outreach Program

On Thursday, October 20, 2011, Rachel Ney, the Tax Section's Pro Bono Staff Counsel, and the Pro Bono Committee plan to host another outreach program at the ABA Tax Section meeting in Denver. But we need your able and enthusiastic assistance—so please join the Pro Bono Matters super hero team by contacting Francine Lipman (Chair of the Tax Section's Pro Bono Committee) at Lipman@chapman.edu at your earliest convenience. Pro Bono Matters! ■

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- The taxpayer is a U.S. citizen or resident alien. (The exceptions allowing a nonresident alien to qualify are beyond the scope of this article.)
- The taxpayer is not claimed as a qualifying child by anyone else.
- The taxpayer (and anyone the taxpayer includes on his or her return) has a Social Security number.
- The taxpayer's investment income is within the limits of section 32(i).
- If married, the taxpayer does not use the married filing separate status.

Additional rules apply to taxpayers who do not claim children. The taxpayer must live in the United States for more than half of the year; must be at least 25 but younger than 65; and must not qualify as a dependent for someone else. I.R.C. § 32(c)(1)(A)(ii).

The EITC is further complicated by the additional rules for determining if a child can be claimed as a qualifying child. The child must be related to the taxpayer in a manner described in section 152(c)(2). The child must have the same principal place of abode as the taxpayer for more than half of the year. The child must be under age 19 (or 24 if a student) and be younger than the taxpayer. A child who is permanently and totally disabled is treated as meeting the age requirements. Finally, the child must not have filed a joint return (except to claim a refund). I.R.C. § 32(c)(3).

Problems with the EITC

One problem with the EITC is that, even though the rules seem straightforward, it confuses many taxpayers. Obviously, if taxpayers do not understand the rules they cannot determine if they qualify. This confusion leads some taxpayers to not claim the credit. It is estimated that 20% to 25% of qualifying taxpayers do not claim the credit. *About EITC*, *supra*.

The second and related problem is noncompliance. It is estimated that EITC noncompliance cost the Service between $9.6 billion and $11.4 billion in 2005. Treasury Inspector General for Tax Administration, *The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments* 1 (Ref. No. 2009-40-024, 2008), *available at* http://www.treasury.gov/tigta/auditreports/2009reports/200940024fr.pdf. To deter erroneous claims, the Service relies primarily on two tools: audits conducted on questionable claims and recertification requirements once a claim has been rejected. It should be noted that from the Service's point of view, in addition to outright fraud, noncompliant claims include any claim where the taxpayer did not participate in the audit process or did not provide the appropriate documentation to substantiate the EITC claim.

Low-Income Taxpayers and the Service

To understand the noncompliance problem, we first need to consider some common attributes associated with a lack of resources that negatively affect many low-income taxpayers' ability to navigate the audit process. These issues have been previously addressed by Leslie Book, who has written extensively on issues affecting low-income taxpayers. Leslie Book, *The IRS's EITC Compliance Regime: Taxpayers Caught in the Net*, 81 Or. L. Rev. 351 (2002).

Mobility

Finding and maintaining safe housing can be a major obstacle for many low-income taxpayers. This often means frequent moves and even periods spent in temporary housing situations or homelessness. High rates of mobility can affect a low-income taxpayer's ability to begin and stay with the audit process until it is completed.

This type of crisis situation is not limited to housing. Many low-income taxpayers face multiple strains on their limited resources, which can include child care costs, transportation problems, health care expenses, etc. At any time one of these issues may pop up and demand the low-income taxpayer's full attention. These crises often trump an EITC audit, which takes an average of eight and a half months to resolve. National Taxpayer Advocate, *FY2010 Objectives Report to Congress* xx, *available at* http://www.irs.gov/pub/irs-utl/fy2010_objectivesreport.pdf.

Literacy

Low literacy rates also create an obstacle for low-income taxpayers. This problem affects taxpayers' ability to fully understand their rights and responsibilities. We already know that the EITC rules are confusing for many taxpayers. Low literacy rates can exacerbate this problem. Literacy problems also pose an obstacle to taxpayers who do not speak English as a primary language.

Fear of Government

Low-income taxpayers, like taxpayers in general, are often wary of the government and the Service in particular. For an EITC audit, the Service asks taxpayers to supply personal information—including marriage and birth certificates, medical and school records—as well as financial records. Many taxpayers are wary about sharing this information. However, they are also nervous about what will happen if they pursue their case. As Professor Book explains, "Many taxpayers are unsure what would happen if they tried to validate eligibility, and do not want to get in trouble by compounding what they believe might have been an initial error on their part, even if in fact they were right in the first instance." Book, *supra*, at 402.

Mental Health Issues

Adults living in poverty are four times more likely to report "serious psychological distress" compared to adults with income at least twice the poverty level. National Center for Health Statistics, *Heath, United States, 2009*, at 8, *available at* www.cdc.gov/nchs/data/hus/hus09.pdf. The presence of a mental health problem can impact a low-income

taxpayer's audit participation in many ways. For instance, a taxpayer with severe anxiety or depression may struggle to simply open the mail, let alone participate in the EITC audit process.

The EITC Audit Process

Now that we know what problems the typical low-income taxpayer brings with them to an audit, we can discuss the audit process. In 2007, 83% of all individual audits conducted by the Service were correspondence audits. National Taxpayer Advocate, *2008 Annual Report to Congress*, vol. 1, at 244, *available at* http://www.irs.gov/pub/irs-utl/08_tas_arc_intro_toc_msp.pdf. This means the taxpayer is "expected to establish the correctness of positions taken solely by exchanging documents and correspondence with an IRS examiner." Book, *supra*, at 375.

The Service begins the audit by sending an initial letter to the taxpayer with a proposed assessment and an explanation for the audit. A form is generally enclosed with this initial contact which explains the different documents that can be used to substantiate an EITC claim. If the taxpayer does not respond to the initial notice, or sends insufficient documentation, the Service will issue a second notice, which comes with a 30-day deadline. If the second notice is not responded to, or is responded to insufficiently, the Service will issue the statutory notice of deficiency, providing the taxpayer with a chance to file a petition in Tax Court.

EITC Recertification

If a taxpayer fails to prove eligibility during an EITC audit, his or her account will be marked with an "indicator," which prevents any future EITC claims until the taxpayer completes the recertification process. Treasury Inspector General for Tax Administration, *While Progress Has Been Made, Limits on the Number of Examinations Reduce the Effectiveness of the Earned Income Tax Credit Recertification Program* 2 (Ref. No. 2008-40-131, 2008), *available at* http://www.treasury.gov/tigta/auditreports/2008reports/200840131fr.pdf. Recertification requires that the taxpayer file Form 8862 with subsequent tax returns. If there is any error on Form 8862, the EITC will be disallowed. Treas. Reg. § 1.32-3(c).

Clearly, the Service needs to strike a balance between deterring fraudulent claims and promoting valid claims. Audits and the recertification process are useful tools. However, if the Service adopts procedures that the typical low-income taxpayer is unable to comply with, it will be denying eligible users access to one of the largest available welfare benefits.

Barriers for Low-Income Taxpayers

The 2007 NTA study referenced above indicates that, in fact, some eligible low-income taxpayers are being denied the EITC. As mentioned above, the 2007 NTA study showed that represented taxpayers had greater success during the EITC audit process as compared to unrepresented taxpayers.

In that study the NTA further looked at obstacles that exist for low-income taxpayers. The results were collected by "targeted interviews" with Low Income Taxpayer Clinic attorneys, comments from tax preparers during Taxpayer Advocate focus groups, and survey results from taxpayers who had been audited in 2004. This information was then broken down into three categories: communication, documentation, and process. National Taxpayer Advocate, *2007 Annual Report*, *supra*, vol. 2, at 94.

Communication

One would expect communication problems to flourish when the Service relies on correspondence to resolve tax problems with a population of people having high mobility and low literacy. A separate study by the NTA found that nearly six percent of taxpayers chosen for an EITC audit had their case closed because the initial notice was undeliverable. National Taxpayer Advocate, *2005 Annual Report to Congress*, vol. 1, at 100, *available at* http://www.irs.gov/pub/irs-utl/section_1.pdf.

When the taxpayer receives the notice, the situation is even more serious. In the 2007 study, the NTA found that over 25% of the taxpayers who received the initial notice did not know that they were being audited. Almost 40% did not understand what the Service was questioning. National Taxpayer Advocate, *2007 Annual Report*, *supra*, vol. 2, at 103. Receiving notification and understanding the issues involved are crucial steps to successfully participating in an audit.

Documentation

During the course of a correspondence exam, the Service will request documentation from the taxpayer to substantiate their EITC claim. This exchange of documents is the essence of the process; a taxpayer who cannot comply will not be successful in the audit. The NTA found that 60% of the taxpayers had a difficult time obtaining documents. The reasons included: taking time off work, not being able to find papers, not keeping records, not knowing what documents were required, not knowing where to get the documents, and having to pay for the documents. National Taxpayer Advocate, *2007 Annual Report*, *supra*, vol. 2, at 106.

Process

The NTA has found that 46% of taxpayers prefer telephone communication and 23% prefer face-to-face communication when it comes to resolving their tax issues. National Taxpayer Advocate, *2007 Annual Report*, *supra*, vol. 2, at 107. However, the majority of EITC audits are conducted by correspondence. Problems with the correspondence process include "mishandling of taxpayer correspondence…a lack of one-on-one contact with taxpayers…and inconsistent, sometimes ignored policies and

procedures ….” National Taxpayer Advocate, *2008 Annual Report*, *supra*, vol. 1, at 243. To make matters worse, oftentimes the Service does not assign a particular worker to each case. This can make following up with a case time-consuming as taxpayers have to start from the beginning in subsequent phone calls to the Service. As previously discussed, a low-income taxpayer may be struggling to juggle various crises at any given time. Without a timely resolution it is easy to see how a low-income taxpayer can fall out of the audit process.

Reliance on Tax Preparers

In 2008, 66% of returns with an EITC claim were prepared by paid preparers. Treasury Inspector General for Tax Administration, *Actions Can Be Taken to Improve the Identification of Tax Return Preparers Who Submit Improper Earned Income Tax Credit Claims* 1 (Ref. No. 2010-40-116, 2010), *available at* http://www.treasury.gov/tigta/auditreports/2010reports/201040116fr.pdf. It’s not surprising that a majority of taxpayers claiming the EITC rely on the assistance of paid preparers. Unfortunately, recent undercover visits by personnel from the Government Accountability Office and TIGTA found that many unenrolled preparers did not ask the basic due diligence questions for taxpayers claiming the EITC. National Taxpayer Advocate, *FY 2011 Objectives Report to Congress* 24 n.119, *available at* http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf. This problem is being addressed by the Service with plans to strengthen the regulation of paid tax return preparers. Internal Revenue Service, *IRS Begins Enforcement of New Return Preparer Rules*, IR-2011-47, Apr. 25, 2011, *available at* http://www.irs.gov/newsroom/article/0,,id=238806,00.html. Until this reform has a chance to become effective, low-income taxpayers will remain at risk for receiving bad tax advice.

How Pro Bono Professionals Can Help

Fortunately, there are ways that the pro bono community can assist low-income taxpayers. First and most importantly, tax professionals can bring their knowledge and experience. For instance, tax professionals can assure taxpayers that their case has merit and lay out a roadmap for the process. A professional’s familiarity with the bureaucratic nature of the Service can also help the taxpayer. For instance, a professional can focus the taxpayer on the pertinent documents and offer time-saving advice, such as to not send original documents to the Service.

Second, tax professionals can bring their advocacy skills. Tax professionals know which arguments to make and how to make them. This level of skill is much more than the typical low-income taxpayer has gained. Having a committed group of tax professionals to guide taxpayers may also curb the need for taxpayers to rely on dishonest preparers in the future.

Last, tax professionals can offer stability. With high levels of mobility, notices are often lost or not received and records are hard to pin down. By receiving information on behalf of the taxpayer, a tax professional can improve the chances that a taxpayer will complete the audit process even if temporarily homeless or forced to move during the time it takes to resolve the case. ■

An EITC Case Study

By Rodney A. Lake*

Given the Service’s high audit rate of Earned Income Tax Credit (EITC) claims, pro bono representation of taxpayers is essential to ensure fair treatment and appropriate resolution of their cases. Despite obstacles faced by many taxpayers claiming the EITC—including low literacy and mental health challenges—the Service arguably does little to ensure that its expansive approach to rooting out EITC fraud produces fair results in individual cases. Rather, low-income taxpayers are forced to communicate with an agency they often find intimidating, in a language they do not always fully understand, in order to satisfy what is ultimately a relatively simple test for claiming the EITC.

As with any representation before the Service, my role as an attorney for individual taxpayers in EITC cases is to help them navigate the system and to translate their arguments into the language the Service likes to hear. This function is especially important in EITC cases because of the relative vulnerability of the taxpayers. Assuming proper entitlement to the EITC, these individuals often struggle to provide basic food and shelter for their families. But while the dollar amounts at issue are significant to the affected taxpayers, they rarely justify hiring paid counsel.

An EITC case that I recently handled involved a young, single mother who shared custody of her son with her former spouse. After meeting with the taxpayer and reviewing her materials, I determined that she was entitled to the claimed EITC benefits. The Service had questioned her claims, suspending an otherwise-refundable credit. Specifically, the Service asserted that her son was not a qualifying child because he did not reside with her for more than six months in either of the

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years at issue. With respect to the first year, the IRS argued that because a court awarded each parent equal custody of the child, the taxpayer could not establish that the child lived with her for more than six months. That judgment, however, was not issued until October, prior to which the child lived exclusively with the taxpayer. During the subsequent year, notwithstanding the judgment granting equal custody the child spent more time with the taxpayer than he did with his father. The taxpayer had contemporaneously maintained a calendar reflecting the child's division of time between households, which accurately reflected that the child lived with her for more than half the year.

Despite our explaining these circumstances and producing the appropriate documents, the Service nevertheless disallowed the EITC claims and issued notices of deficiency to the taxpayer. We petitioned the United States Tax Court for redetermination of tax liabilities, and in relatively short order the case was forwarded to Appeals for reconsideration, where it was quickly resolved in the taxpayer's favor without additional argument. The average underrepresented taxpayer is often unable to successfully resolve cases like this one, in which the substance is clear but the procedure complex.

This case is representative of an obstacle faced by countless taxpayers who are denied tax benefits, and who lack either the resources or abilities to navigate the bureaucracy necessary to resolve their claims successfully. Serving as a central, stable contact for the taxpayer in dealing with multiple parties and offices at the Service, as well as the U.S. Tax Court, helped to facilitate an outcome that perhaps should have been achievable at a much earlier stage. Without this assistance and procedural knowledge, however, the taxpayer would not have received the EITC benefits to which she was properly entitled. ■

TAX Bites

Sing Along with Tax Bites

By Robert S. Steinberg*

Taxes Are Here to Stay

(To the tune of "Our Love Is Here to Stay" by George and Ira Gershwin.)

It's very clear
Taxes are here to stay.
Each day and year
We are the taxman's prey.

One hears that Congress cut spending
Of taxation ending,
By those presumed to know,
After whose re-election
Wither their votes do go.

And so I fear
Taxes are here to stay.
Yet don't despair
Reform is near they say.

Obama's health care may crumble
Tax brackets tumble
Tea Parties lead the way
But taxes are here to stay.

Extra verse:

So grin and bear
Taxes are here to stay.
Unjust, unfair?
Tax is the price we pay.

For love of civilization
Freedom and nation
Here in the U.S.A.
Taxes are here to stay.

You Can't Take That Away

(To the tune of "They Can't Take That Away" by George and Ira Gershwin.)

Intro

There've been many goodies added to the tax code as it grew
Here are some that we've become addicted to.

Verse

The 401 small (k)
The corporate R&D
You want to take away?
No, no, you can't take that away from me.

Home mortgage interest prized
By every family
Think of that home downsized
No, no, you can't take that away from me.

Bridge

We can't solve the budgetary crisis
We've grown wary of
Lest we all give up some tax breaks dearly loved.

Verse

My contributions for
The art of Johns or Klee
Allowed not anymore?
No, no, you can't take that away from me.

The rate on long term gains
Health benefits tax free
The lobbyist complains
No, no, you can't take that away from me.

You can't take that away
More campaign cash I'll pay
You can't take that away from me.

I've Got a Good Tax Shelter for You

(To the tune of "I've Got a Lot of Living to Do" from the Broadway show "Bye Bye Birdie," lyrics by Lee Adams and music by Charles Strouse.)

Want a scheme to lower your tax rate?
To postpone tax properly due
If your goal is becoming jail bait
I've got a good tax shelter for you.

Lie awake just thinking of patents
That will make a million or two
You're in one, well call me when that ends
I've got a good tax shelter for you.

There were cattle to buy
Oil wells to drill
Movies as tools
All designed for gullible fools.

If you send from prison a letter
I may be vacationing too
Sentenced as an aid and abettor
But look me up when your term is through.
I've time to plan a new deal or two
I've got a good tax shelter for you.

There's No Business Like Tax Business

(To the tune of "There's No Business Like Show Business" from the Broadway show "Annie Get Your Gun," music and lyrics by Irving Berlin.)

There's no business like tax business
The tax biz is for pros.
Many find the subject unappealing
Debating what the tax law will allow
In thankful prayer the tax lawyer is kneeling
It isn't stealing
Milking the cow.

There're no lawyers like tax lawyers
They smile: why? No one knows.
Yesterday some thought it smart to park offshore
A bank account from a lucky score.
F-BAR the forgotten thought not any more
How safely to disclose?
And so on the show goes.

* Robert S. Steinberg PA, Miami, FL.

Boxscore

Since April 2011 the Section has coordinated the following government submissions, which can be viewed and downloaded free of charge from the Section's website at http://www.americanbar.org/tax.

Submissions and Comments on Government Regulations, Administrative Rulings, Blanket Authority, and ABA Policy

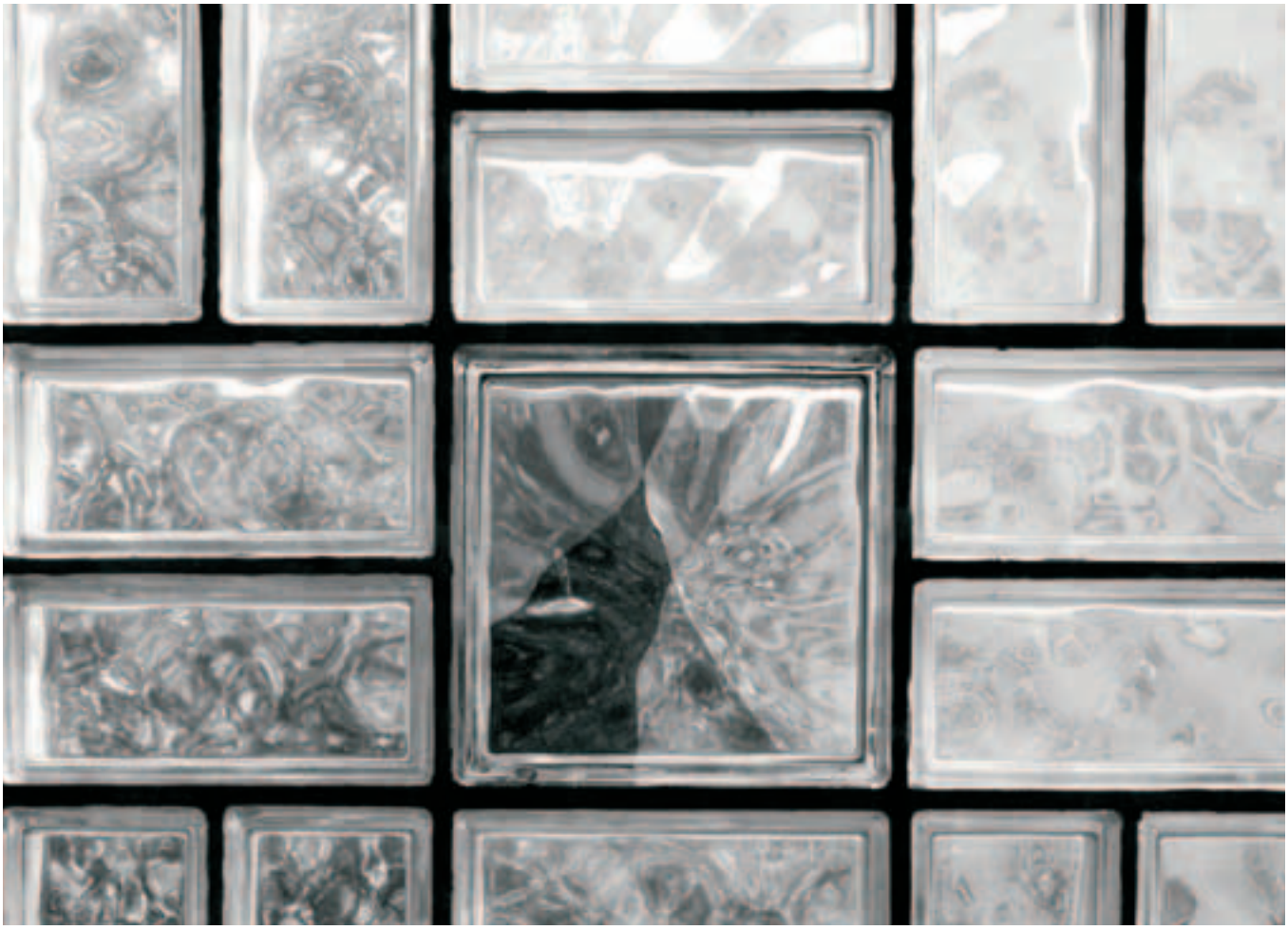
TO	DATE	CODE SECTION	TITLE	COMMITTEE	CONTACT
Internal Revenue Service	5/18/2011	643, 679	Comments on Provisions of the HIRE Act Regarding Foreign Trusts with U.S. Beneficiaries	Fiduciary Income Tax	H. Carter Hood
Department of Labor	5/4/2011	ERISA	Comments on the Interim Final Regulations Relating to Compensations to Service Providers Under Section 408(b)(2) of ERISA	Employee Benefits	Andrew L. Oringer, Joni L. Andrioff
Internal Revenue Service	5/4/2011	105	Comments in Response to Notice 2010-63 Concerning Requirements Prohibiting Discrimination in Favor of Highly Compensated Individuals in Insured Group Health Plans	Employee Benefits	Alden J. Bianchi, John L. Utz
Internal Revenue Service	4/29/2011	301, 355, 368, 704, 6231	Comments on Proposed Regulations on Series of a Domestic Series Organization	Partnerships and LLCs	Paul Carman

The technical comments and blanket authority submissions listed in this index represent the views of the ABA Section of Taxation. They have not been approved by the ABA Board of Governors or the ABA House of Delegates and should not be construed as representing the policy of the ABA.

ABA Section of Taxation CLE Calendar

www.americanbar.org/groups/taxation/events_cle.html

DATE	PROGRAM	CONTACT INFO
September 15-16, 2011	**ALI-ABA Advanced Course of Study: How to Handle a Tax Controversy at the IRS and in Court** Hilton Washington Embassy Row – Washington, DC	ALI-ABA www.ali-aba.org 800.CLE.NEWS
September 21, 2011	**Practical Problems and Practical Solutions for Private Foundations** CLE Teleconference and Live Audio Webcast	Tax Section www.americanbar.org/tax 202.662.8670
October 13-14, 2011	**ALI-ABA Advanced Course of Study: Tax Exempt Organizations** Hilton Washington Embassy Row – Washington, DC	ALI-ABA www.ali-aba.org 800.CLE.NEWS
December 1-2, 2011	**28th Annual National Institute on Criminal Tax Fraud** Wynn Las Vegas – Las Vegas, NV	Tax Section www.americanbar.org/tax 202.662.8670



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SAVE THE DATE

2011 Law Student Tax Challenge

An alternative to traditional moot court competitions, the Law Student Tax Challenge asks two-person teams of students to solve a cutting-edge and complex business problem that might arise in everyday tax practice. Teams are initially evaluated on two criteria: a memorandum to a senior partner and a letter to the client explaining the result. Based on this written work product, six teams from the J.D. Division and four teams from the LL.M. Division will receive a free trip (including airfare and accommodations for two nights) to the Section's 2012 Midyear Meeting, February 16-18 in San Diego, CA, where they will defend their submissions before a panel of some of the country's top tax practitioners.

The competition is a great way for law students to showcase their knowledge in a real-world setting and to gain valuable exposure to the tax law community. On average, more than 50 teams compete in the J.D. Division and more than 30 teams compete in the LL.M. Division. For more information, visit the ABA Tax Section webpage at www.americanbar.org/tax or contact the Tax Section at taxlserve@americanbar.org or 202-662-8670.

Important Dates:

- **Problem Release Date:** September 2, 2011
- **Submission Deadline:** Friday, November 18, 2011 (5:00 PM EST)
- **Notification of Semifinalists and Finalists:** December 19, 2011
- **Semifinal and Final Oral Defense Rounds:** Friday, February 17, 2012 in San Diego, CA