Defending Liberty
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PRO BONO MATTERS

Paying It Forward in Pasco

By Francine J. Lipman*

Money matters. And to the increasing population of poor families in America it can and does change lives. In *Taxing the Poor: Doing Damage to the Truly Disadvantaged* (University of California Press 2011), Katherine S. Newman and Rourke L. O'Brien demonstrate the compelling and chilling impact of increasing average income for poor families in America. Their research demonstrates that as average income of poor families increases, age-adjusted average mortality decreases (disproportionately impacting the poor, but affecting the *entire* population). High school dropout rates, crime, and single parent households also decrease when average income increases. Simply put, when poor families have more money "negative outcomes diminish and positive ones increase" for everyone. And the positive outcomes increase exponentially, especially when financial resources are allocated to poor children.

Poverty is most devastating for America when it imprisons our youngest children. As a result, money matters most for families with children. Nobel Prize-winning economist James Heckman has estimated that economic investments in young children return $8.70 to society for every dollar spent. Recent studies have found that a $1,000 increase in annual household income increased children's combined math and reading test scores in the short run by 6% of a standard deviation with the greatest improvement in the most disadvantaged households. Similar studies have found that children are more likely to stay in school and significantly less likely to commit crimes if their households have more money. Money that Harvard sociologist Kathryn Edin has tracked in her studies of tax refund recipients that is used to pay off credit card bills, overdue rent and utility charges, or to buy much needed cars, refrigerators or food. Money that saves lives by meaningfully reducing unhealthy household anxiety, stress, likelihood of eviction, and utility shut-offs as well as food insecurity.

Getting money into working poor households is critical for the future of all Americans. And we do much of this work through the income tax system, most effectively with tax credits including the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC). Low-income taxpayer clinics (LITCs) and pro bono tax lawyers are on the front lines throughout America, facilitating this process to maximize net tax refund dollars for these families.

Ana Cecilia Lopez, a 2012-2014 ABA Tax Public Service Fellow, and first generation immigrant, is doing this work and making a positive difference in the everyday lives of the people of Pasco, Washington. Through the University of Washington's LITC and MicroEnterprise Assistance Program, Ms. Lopez is working with Pasco community members to break the pernicious cycle of poverty that imprisons more than 75% of Pasco residents. Because of her Fellowship, funded by the Section, Ana Cecilia is able to provide hands-on access to tax assistance that would otherwise not exist in Pasco. Money matters, and Ana Cecilia is paying it forward every day by ensuring that tax justice prevails in Pasco.

* William S. Boyd Professor of Law, University of Nevada, Las Vegas, William S. Boyd School of Law, Las Vegas, NV.

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September 19-21, 2013	JOINT FALL CLE MEETING	Hyatt Regency – San Francisco, CA
January 23-25, 2014	MIDYEAR MEETING	Arizona Biltmore Resort & Spa – Phoenix, AZ
May 8-10, 2014	MAY MEETING	Grand Hyatt – Washington, DC
September 18-20, 2014	JOINT FALL CLE MEETING	Sheraton Downtown – Denver, CO
January 29-31, 2015	MIDYEAR MEETING	Hilton Americas – Houston, TX

If You Missed the Last Section Meeting

MATERIALS

View and search hundreds of papers and materials presented at the Section's Fall, Midyear, and May Meetings on Westlaw. This member service is made possible by West, a Thomson Reuters business—a publishing sponsor of the Section of Taxation. For more information, go to the TaxIQ tab of the Meetings & CLE page at www.americanbar.org/tax.

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From the Chair

By Rudolph R. Ramelli*

A year passes by much more quickly when you are looking back rather than looking forward. Such is the case with my year as Chair of the Section. Looking forward a year ago the task of being Chair seemed fairly intimidating. There were three meetings on the horizon which means officers' agendas, council agendas, and plenary session agendas that need to be planned and implemented. Visits with the Treasury and Internal Revenue Service as well as meetings with the staff of the tax writing committees had to be planned and executed. In addition to that, the behind-the-scenes working of the Section needed to be tended to and advanced.

All in all, I believe the year went well. While not accomplishing everything I wanted, I believe we did advance some of the projects set forth in the long-range planning undertaken by my predecessor Bill Paul. We adopted a new mission statement, established a publications task force to look at the Section's publications going forward, revised the structure of our international programs, and increased the effectiveness of our pro bono programs through the newly focused Vice Chair of Pro Bono and Outreach. There is still a lot to be done, but a long-range plan is just that, something that is accomplished over time. I know Michael Hirschfeld is already looking at items from the long-range project.

Our three meetings were well attended. In Boston last fall we had almost 1,100 registrants, in Orlando in January almost 1,200 registrants, and in Washington in May—traditionally our largest meeting of the year—our registration reached almost 2,100. Our Committees did their usual job of providing first-rate and cutting-edge panels with the purpose of educating both our Members and our government guests.

We were lucky to have Commissioner Shulman give one of his last speeches before his retirement as our plenary session speaker in Boston, and at the May meeting Senator Orrin Hatch gave us an insider's view of the prospects and structure of tax reform. In addition, our May meeting turned out to be the venue where the IRS apologized for its handling of Section 501(c)(4) determination letter requests. The reaction and fallout from that is still unfolding.

> Whether or not we plan for it or whether or not we embrace it, change happens.

The Section also continued its written work product with tax reform options submitted to the tax writing committees, bringing the total submitted to date to 12, which were prepared by the following committees: Bankruptcy and Workouts, Corporate Tax, Employee Benefits, Estate and Gift Taxes, Financial Transactions, Insurance Companies, Low Income Taxpayers, Partnerships and LLCs, Real Estate, S Corporations, Tax Exempt Financing, and Transfer Pricing. In addition, the Section submitted 13 sets of technical comments representing the work of 13 committees.

The most significant event of the year, however, was the untimely death of Christine Brunswick, the Section's long-time Executive Director. Chris was a constant. For many of us, she had always been there and, for all we knew, would always be there for the Section. Her loss was not something any of us had planned for. She dedicated over 27 years of her life to the Section and the Distinguished Service Committee rightly awarded Chris the Section's Distinguished Service Award at the meeting in May. I would like to thank Nina Olson for her kind words about Chris in her acceptance of the Award on Chris' behalf.

Whether or not we plan for it or whether or not we embrace it, change happens. A week after the Section's meeting in May, the Section's offices at 740 15th Street were moved to 1050 Connecticut Avenue, NW, as a result of the sale of the building by the ABA. Budget cuts and increased scrutiny of IRS and government travel in general has put pressure on the importance of government guests at our meetings.

On a positive side, however, the appointment of Janet In as Executive Director assures that the Section will continue to provide excellent service to our Members. I congratulate Janet on the appointment and look forward to many years of her leadership.

I would like to thank Council and the Section Officers for all of their work and support over the last year. The contribution that the Section makes to the tax system is due to the work and dedication of its volunteer members. The Officers and Council truly represent the dedication of all of our Section Members.

Finally, I would like to thank the Section Staff for the professionalism and dedication that they exhibited this year. Chris' absence and the Staff's concern for her took their toll. Nevertheless, everything worked and it worked well. It is refreshing to find a group dedicated to a purpose and dedicated to making our Members' experience with the Section a positive one. ■

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From the Chair-Elect

By Michael Hirschfeld*

With thanks to my predecessor, Ruddy Ramelli, the Section Officers and Council, and all of the Tax Section's members, I welcome the opportunity of representing you as our next Chair, and I look forward to working with and hearing from you over the next year as we continue to plan for the future of the Tax Section and carry out the important role that the Section plays in helping to shape our nation's tax system.

A top priority for me as Chair relates to our Section Meetings, which are a valuable resource for CLE, government interaction, and networking. If you have never attended a Section Meeting before, I encourage you to sign up for our Joint Fall CLE Meeting in San Francisco on September 19-21. Registration is complimentary for first-time attendees, so don't miss it. The Meeting provides a number of opportunities to help you get the most from your first Tax Section Meeting, including a Young Lawyers Forum, a complimentary Welcome Reception and First-Time Attendees Dinner, and a host of programs that are tailored to new tax lawyers and those transitioning to tax. If you have taken a break from meeting attendance, I want to invite you back since, among other benefits, Tax Section Meetings offer the best CLE at the most affordable price in the nation. Also, the face time with fellow practitioners and government representatives is equally valuable—something that can be lacking in our increasingly wired and social media-conscious world where we don't get the same level of personal interaction.

Many of our members who come to our meetings have expressed a desire for the Section to consider revising its long-standing Friday-Saturday meeting format to respond to changing needs of members who are juggling multiple professional and personal time pressures. We are listening. With that in mind, we will be undertaking a member survey this year to measure the level of interest in, for example, changing the format of our Fall and/or Midyear Meetings from a Friday-Saturday focus to Thursday-Friday. Just as our professional lives are changing to meet the economic challenges and realities of law practice today, member involvement and what it means to be active in the Section is also changing. Whatever the shape our future Section Meetings take, the goal will be to allow us to better interact with you and to make it easier for you to participate, which leads me to my next priority.

> Whatever the shape our future Section Meetings take, the goal will be to allow us to better interact with you and to make it easier for you to participate.

I want to encourage members who have not been active to get involved in one Section activity this year. The best way to do this is to become a member of a Section committee. With over 40 substantive committees, there are always opportunities to contribute for those who wish to do so. For a list of committees with links to their respective webpages and leadership contacts, go to: http://www.americanbar.org/groups/taxation/committees_task_forces.html. The substantive expertise of the Section's committees is vital to the success of every aspect of the Section—from providing the content for its CLE programs and publications to its relations with and submissions to government, to its efforts to support tax lawyers interested in doing pro bono work. Those who are new to the practice are especially welcome, since you are our future, and we have already seen some newer members behind the success of some of our more recent government submissions.

In an economy that still has not resumed its pre-2008 vitality, jobs are a number one concern for many of our members. On the resources page of the Tax Section's website, we have a Job Locator Program site; while this was first established for law students seeking jobs, we will be expanding this to cover jobs for those in the field. For employers, this is a valuable way of posting listings that reach out to the best talent in the nation without incurring a fee. We invite you to post your listings, and for those looking for a job change, we hope to make this a valuable place to check.

Please join me in welcoming our new Executive Director, Janet In. While we were greatly saddened this year by the loss of Christine Brunswick, our dedicated and beloved Executive Director for more than two decades, Janet was trained by Christine and brings many years of experience as a member of the Tax Section staff, so continuity of leadership and a smooth transition is assured. We are in good hands with Janet and her enthusiastic staff who are here to help us and are a resource for you to draw upon.

Lastly, I hope you all have a great summer and I invite you to contact me directly with your ideas and questions about Section matters—my email address is michael.hirschfeld@dechert.com. ■

* Dechert LLP, New York, NY.

INTERVIEW

Charles O. Rossotti

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

Charles O. Rossotti is currently affiliated with The Carlyle Group. He served as Commissioner of the Internal Revenue Service from 1997 to 2002.

Q What was the biggest surprise you encountered when you started as Commissioner of the Internal Revenue Service in late 1997?

A That I could not communicate with the employees because there was no email system and no voicemail system other than for the National Office. Even in 1997 that was a bit of a surprise, to say the least.

Q How quickly were you able to find a way to communicate within the large organization?

A I had to use other means, none of which were particularly efficient. Eventually, of course, we solved that problem. That was a practical problem at the beginning but also an indicator of where the agency was at that point in time. It is hard to even believe that in today's world, but it was true.

Q Is there anything you miss about being the Commissioner of Internal Revenue?

A I could probably say not a whole lot, but I would make one exception—I think some of the people that I dealt with were just really special. A few of them I keep up with today, especially Bob Wenzel, a senior civil servant who eventually became my Deputy Commissioner. He is just one of the best people I ever knew anywhere. I just use him as an example, because there were others as well. I mean I think if you are in any kind of an institution for any length of time and you have any success with it at all, I think you do build bonds with people. Certainly that was true for my time at the IRS.

People occasionally ask me, "Did you enjoy being Commissioner?" and I say, "Well, it was not enjoyable like spending a day at the beach, no." But, I am glad that I took the job and did it, and hope that I made some impact in a positive way, and I think we did. I think that was the piece, meeting and building bonds with some people, that was good. The rest of it—it was a job to do and we did it.

Q How difficult did you find it to modernize the IRS?

A When people talk about "modernizing" the IRS, that term had been used primarily to focus on bringing in some new computers. They did try to do that as a separate item, and that did not work well. In fact, that was one of the things that led to the problems in the so-called crisis of the mid-90s. They had tried to "modernize" the computer systems, which absolutely had to be done. Ironically, probably one of the main reasons I was asked to take the job was that Treasury Secretary Rubin could not find anyone willing to take it. The other reason I was asked was because I did have a technology background that they knew they needed. In fact, one of the headlines in *The Washington Post* when I was announced was, "A computer technician takes on IRS job." So they thought I was going to go and fix the hardware. In reality what was obsolete—and it really was obsolete—was a much broader concept of modernization, which was just how the place was organized, how it ran, what its practices were.

Those practices had been very advanced when a lot of it was created in the 50s and early 60s. But now it was a little more than 30 years later, many of those things had been retained, although what they had done, which actually made it more complicated, was layer on some new things on top of the old things without ever figuring out how it was done. If you think of your house, for example—you had a really old house and you never really fixed anything, but you just layered on some new equipment or something, and so eventually the plumbing would not work, or the electricity would not work—that was really the IRS. It had made a lot of incremental changes but it had never really thought about how to run something that big and complicated in today's world, and that was really what was going on. There was no quick fix.

Changing anything that big while you are still continuing to operate is problematic, because you still cannot say, "Since we have a lot to do—let's skip tax season this year. We will put that off until next year." No, you could not do that, so you had to keep running everything as best as you could. In addition to that, you had to also try to show that you were doing something practical to improve because there were a lot of complaints. My first round of

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courtesy visits on the Hill, I would go in and whoever was there of the staffers would say, "Well, let me introduce you to Sally, she is our full-time person just tracking down IRS problems for our constituents." Every office had an IRS person fielding complaints about the IRS and that was the tip of the iceberg. You could not just say, "Well, give me five years and we will come back and make it better." You had to do some things along the way.

This is not unique to the IRS—this is basically what is involved any time you are dealing with any kind of a sizable business or organization that needs to be brought up to date or improved in some major way.

Q Did you help the IRS run somewhat more like a business?

A People say that, and there is some truth to it, but there is also some not truth in it. I did bring in Larry Langdon, and there were 15 or 20 people that I brought in at different times from different businesses to come in to help with certain things. The first thing you have to understand is that there are things that we can learn from a variety of organizations and businesses about how certain kinds of things are done. A lot of the activities that the IRS does are very similar to other activities that businesses do. Yes, we do auditing, and there are a lot of people who do auditing of different things and they have pretty good ways of doing it. We answer telephones, and answering the telephone to answer questions is not something that is unique to the tax system. There are a lot of things like that, but at the same time, we are not a business. We do not have a bottom line—we are a government agency, we have to conform to law from the Constitution, to the tax code and regulations, to the courts and to the practices that we are given in procurement and personnel and everything else. So what we are trying to do is to learn from what we can do to improve what we do, but we are not going to become a business because we are not a business.

So when people say that, I think the answer is that there are some very significant things that can be learned and taken, but not to say that you are going to actually "be" a business.

Q What was your greatest challenge during your time as Commissioner?

A Actually the greatest challenge was not technology—technology took time, and of course we did not fix all the technology while I was there, that was not even in the cards to do. Reorganizing was a challenge, but given enough time and doing it right, that was a challenge that could be addressed. The most intractable challenge I faced was the budget. I was never able to solve that problem. The way the budget process works, and the outcome of the budget process, is completely irrational. As far as I know, it still is. I do not know what is happening today with the sequester and all, but the reality is that if you are going to have more tax returns, more taxpayers, a lot more tax regulations and tax code, and on top of that you have got a lot of very smart people out there trying to game the tax system—you do need some resources. I mean you can do some things with technology and efficiency, but you do need some resources, and the IRS had been cut before I got there. It had been cut substantially just in terms of personnel—they were down 20 thousand people the previous five years. The IRS has fewer staff today than it had 25 years ago.

It is true that technology can make up for some of that. The other side of it is that we never were able to get the money to invest in technology. I did some comparisons—and as far as I know this is still true today—we did get some money to invest in technology, but if you were to look at it compared to any one of the large banks, it would be ten percent. They would spend ten times as much per year. This IRS is just as complex, there are different forms of complexity, but it is complex and it is big. It is also highly sensitive. You look at things like information security, which is a big topic now. Think about trying to deal with 150 million individuals and 6 million businesses and store all that information and have it accessible and be absolutely 100% on privacy and security. You do not do that so easily. The funding is utterly, utterly senseless. What it amounts to is that it is not saving any money for the government because you are leaving vast amounts of money on the table, not all of which could be collected, but over time with the right investment a significant amount could be collected, and it would be way more than what we would invest. I tried to make that case and it was never really successful. One or two years I got a little bit, but it was not sustained.

And the other big thing about the budget is really surprising—that was true in both the Democratic and the Republican administrations—the problem is not Congress—it was the White House. For the whole five years that I was there, I was able to get somewhere around 98% of what was in the official budget request from the White House. Naturally the Congress fussed with us, but ultimately I was able to get like 98%. I wish I could have gotten 100%. There was no way they were going to give me more than 100%, right? But the problem was getting a high enough amount into the budget request submitted to Congress by the White House. The White House just never viewed it as a priority under either administration. They still do not, as far as I know. What little I know about what has happened since then, it has been pretty much the same story. That is the most irrational thing I can tell about the tax system. I was never able to solve it.

Q What was your greatest accomplishment as Commissioner?

A I will tell you how I think of the accomplishment. We made a lot of changes in the way that the organization

was structured, which was big. The technology program, not that we finished it, a lot of things about the strategy—organization and enforcement strategy—which people do not talk about as much, but the way that the Service worked, and since then there have been two Commissioners—and we have had 11 years go by—I have known both of them. I think they have both done very well. What has been good is that they have essentially adopted the foundation of the things that we started. I mean there were many different things that were changed, and they all had their own strategies which is appropriate, but I think it has been a cumulative effect.

As a result, notwithstanding that I do not think that it is anywhere as good as it should be because of the lack of funding, the reality is that the IRS continues to be viewed as competent. For example they have given the IRS half of the health care law to be administered. I was actually trying to avoid having more things assigned to the IRS. Once it started to function better, they gave all these programs for special refunds and one time benefits to IRS. They have been given the health care law. The IRS is almost as much a disbursement agency now as it is a collection agency, which maybe is fine for the federal government, but I do not think it is a great policy. It does seem to be an indicator that the IRS cumulatively, and not just because of what I did, but over time has improved dramatically as far as how it functions as a federal agency.

Q What have you been doing professionally since you left the Internal Revenue Service, and specifically, have you had any involvement in tax matters?

A No, not professionally. I did do one assignment that was not part of my professional work, but back in 2005 President Bush had a bipartisan panel to study reform of the tax code, and I served on that for a year as a volunteer. Other than that, I have really had no involvement. I was not involved in tax before the IRS, and I had no reason to be involved afterwards. What I have been doing primarily is working as a corporate senior advisor at the Carlyle Group. I work on looking at investments, I serve on a number of boards of companies that Carlyle owns, and I have had two other board assignments for public companies not connected with Carlyle. In addition to that, I do some nonprofit work, and I have one nonprofit activity in particular I am involved with. None of that has anything to do with tax, and it is really kind of funny, especially when I get in one of these meetings and something comes up on a deal, and there is always a tax aspect of the deal so those that even remember I was with the IRS say, "Well, you know ask Rossotti what he thinks." I say, "Do not ask me, get the lawyers in from Skadden, Arps or wherever it is, Latham & Watkins—they have the people that know the tax code." I am not a tax expert. Any thought that I am going to get into that or solve that is completely wrong. I have plenty of activities, but none of them are tax-related except for that tax panel I served on for President Bush.

Q From your perspective as a business person today, how does the complexity of the tax system look from the outside?

A It is horrible. I mean, through my involvement on quite a few different boards from large public company boards, and I have been chairman of the audit committee of three large companies, I have seen it from that angle, and of course I keep up with it a little bit in the press. I mean, as bad as it was at the time I left and as complex as it was, it has only gotten worse. On the individual side there have been more and more—call them incentives if you want to—complex provisions that basically try to disburse government benefits in the form of tax provisions. Every time you have one of those things, somebody has to define who is eligible, how it works, who is not eligible, etc. There are going to be people trying to figure out how to put as many people in that tent as they possibly can. Every single one of those creates administrative issues, it creates an enforcement issue, it creates a loss of revenue for the government because no matter how good you do it, there is somebody who is going to game it, and it is going to be expensive. And the IRS has gotten absolutely zero funding to do any of that.

On the corporate side, it is even more of a disaster because you do have these incentives on the corporate side too, but much more than that what you have is a globalized system in the business world. You have two things in the business world that just are very, very significant—one is globalization. I mean, I am on boards of companies here at Carlyle of different sizes from small to large, even relatively medium companies, like a $70 million a year company, which you would consider medium sized, that do business internationally. They are outsourcing products, they are selling things, they have got people in different jurisdictions. Of course almost all large companies are globalized, so you have this whole multi-jurisdictional issue, which you are familiar with in the ABA Tax Section.

And then the other issue is that in significant businesses today, and again it is not just in big companies, the real driver of returns and profitability is innovation and intellectual property in some form, not just software but brands and different forms of intellectual property or effectively codified innovation, if you want to call it that. That is a big problem in conjunction with globalization—that is a huge problem. And then on top of that you have the complexity of the tax code itself in terms of all these provisions. So what you really have is a complete mess.

The corporate tax code in particular really is optimal in one way, in that it probably imposes the most burden and complexity for the least amount of money collected that you could possibly have. On the one hand we have one of the highest corporate tax rates in the world. This is actually a very important fact, because when people look at investments, the rate is the one thing that you know for sure. So, whether you are going to get an ability to somehow not actually pay the rate through credits or moving money, you do not know that necessarily, so what people tend to do conservatively is look at the actual rate and say, "This is what we are going to apply." So in terms of the impact on investment incentives, it actually is a relatively higher rate than there are in other places. But at the same time the government does not actually get that rate because in the back room of the tax department they say, "Well, wait a minute, here is what we can really do so we do not pay this tax." So when you get all done with that you have a really bad system, the corporate tax system does not produce much revenue at all anymore, really, and yet it is a huge factor in the business communities. That is pathetic.

That is why I served on that panel in 2005, and President Bush said that was going to be one of his top priorities in his second term. It was a bipartisan panel, and since then there have been other bipartisan panels, and everybody comes up with the same answer, because there really is only one answer, which is get rid of all this stuff, lower the rates, broaden the base, make it simpler, and use the tax code to collect revenue. It is not being done. So, it is very sad, but I cannot do anything about it anymore.

Q Do you consider yourself the first business person/non-tax professional to be a Commissioner?

A I do not know all the Commissioners, but I think that somebody told me that at least since World War II all of the IRS Commissioners have either been tax lawyers or tax accountants. I think it was true at least since World War II. So I think I may have been the first Commissioner since World War II not to have come from a tax background.

Q What do you think of the trend away from tax professionals with the last three Commissioners?

A First of all, I think the last two Commissioners have not been tax professionals at all, and I think they have done extremely well and I think that it is generally accepted that they did well. Obviously you would think that says that you do not have to have a background as a tax professional. I never took the position that it was wrong to have a tax professional, I think what the real thing is that, unlike maybe in some other countries, the Internal Revenue Service is not a tax policy agency, it has very little to say about tax policy. Yes, we have a say on regulations but fundamentally the tax policy office in Treasury guards that role significantly. I actually think that is quite wise because if the IRS Commissioner were in tax policy, then you would be on the Hill all the time just like the Assistant Secretary of Tax Policy is.

The administration of the tax system, and the administration of the IRS as an organization, is a huge job. It is an enormous agency, it has a lot of management things involved with it. For the most part, anybody from any field would need some real world experience to be really effective at that. It is really tough to be effective at that no matter who you are or what your background is. If somebody had been a tax professional at some point in their careers, and then had gone and been an executive and really ran something significant and somehow gained that executive experience, that would probably be great. It is always better the more you know. I had to be kind of a just-in-time learner about the tax code, and rely on a great general counsel and chief counsels and other people for some of those things, which you should do anyway, by the way, even if you were a tax expert. You still should not do it yourself, you should rely on others. For example, if you are a lawyer and you take over a business you should not be your own general counsel. As a lawyer you would probably agree with that. A mistake some CEOs make is where they were the CFO before and they try to still be the CFO while also CEO, and that is not good. You need to have people who are looking at that full time and have a different point of view. But nevertheless, it is not that it is a bad thing to be a tax specialist, it is just that you need some of these other executive-type experiences, I think, to really take over something like the IRS.

Q If the President called you and asked you what he should consider in selecting his next IRS Commissioner what advice, if any, would you give him?

A Two or three things are important, and they are fairly obvious. I think you do need somebody who has had some successful track record as an executive of something in a significant size organization, because those are just experiences that it just takes time to acquire in any kind of mature fashion. So, that is important. I think if possible—and this was true of the previous two Commissioners—having someone who has had some prior experience in the government is useful. I actually had worked in the government in my early years, which was helpful. To come in completely cold and never having had anything to do with the government, that is a little tough. I did bring in some people from the business sector, most of them had had some government experience or if they did not, I made sure that they got some orientation for several months before we really put them in anything. It can be a culture shock. Again, you always have

to remember that it is not a business. There are some business-like things that should be done, but it is not a business—it is a government agency. We have to remember that. We do have a Constitution, we do have laws, but we do not have a bottom line in the same way as a company does.

So I think those two things are really important—and I would not say that if somebody was really successful and had never been in the government at all you would necessarily disqualify him, but I think that that would be a little tough. The risk would be higher for both the person as well as the administration. In my early years, I did work for the government in the Defense Department for four and a half years. I was in the office of the Secretary of Defense. So it was not anything to do with tax and it was not a high up position, I was in my 20s. I was called the Deputy Assistant Secretary of Defense, but I was working for a senior person. It is a large office, and it advises the Secretary of Defense on different things.

And the third thing I think it would be important for the next Commissioner is to remember that it really is a public service. I mean, anybody who you would recruit for this would need to see it as something that they are doing because they really feel committed to doing a period of public service. If they had any other motivation, and I do not know what that would be, it would not be a good one. So you need to be confident in that. Those are the three things, and that actually creates a wide field to choose from for the next IRS Commissioner. ■

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POINTS TO REMEMBER

Advantage of 401(k) Even with No Capital Gains Tax and Same (or Sometimes Higher) Tax Rate at Retirement

By William K.S. Wang*

Some people assume that a traditional (non-Roth) 401(k) is advantageous only if one is in a lower tax bracket after retirement, or, alternatively, if the capital gains tax rate is greater than zero. Neither assumption is true. The following analysis shows that a traditional 401(k) is attractive even if one has the *same* income tax bracket at retirement and the capital gains tax rate is zero. Indeed, the traditional 401(k) even is sometimes better despite a *higher* tax bracket at retirement.

For simplicity, I make these assumptions:

1. Withdrawals from either the 401(k) or the alternative account will not occur until retirement at an age when the 401(k) withdrawals are subject to no early withdrawal penalty (although the withdrawals are subject to federal income tax).
2. The required minimum distributions (after age 70½) on the 401(k) impose no burden.
3. There will never be state income taxes.
4. The federal income tax rate will remain a flat 50% forever. (I relax this assumption later.)
5. The capital gains tax rate is greater than zero. (Later, I assume a capital gains tax of zero.)

Constant 50% Tax Bracket

Suppose I have two choices: (1) a traditional 401(k) account, with $200; or (2) an extra $200 of taxable salary, with the $100 after-tax proceeds placed in the same type of investment as the 401(k).

At retirement, when I withdraw funds from the 401(k), I must pay the Service half. The Service is like a 50% partner. One could view the $200 401(k) account as two $100 accounts: one "owned" by me, and one "owned" by the Service. Eventually, by formally giving up the account "owned" by the Service, I own the other account outright *with no other tax in the interim*.

If I instead take $200 of taxable salary, I must immediately pay $100 in income tax. Although I have only $100 left to invest, I own the $100 account outright (unlike the $200 in the 401(k), in effect half-owned by the Service). The problem is that although I own the $100 account outright, I must pay tax on any interest, dividends, and capital gains in the account.

Assume that, with all distributions reinvested, the 401(k) triples in value by the time of retirement. The 401(k) will appreciate from $200 to $600, but the Service in effect owns half. Again, one could view the $600 401(k) as two $300 accounts, one "owned" by the Service and the other "owned" by me *with no tax in the interim*.

Had I opted for salary instead of the 401(k), my $100 account would have been invested in the same assets as the 401(k) and grown to $300 *minus any taxes on dividends, interest, and capital gains* in the account.

With the extra-salary alternative, I have *less* than $300 *after taxes*. With the 401(k), I have a $300 account owned outright *after taxes*. I am better off with the 401(k). This is true *even if the tax on capital gains is zero*. The tax on dividends and interest would remain and apply to the extra-salary alternative account.

Retirement Tax Bracket Other than 50%

I shall now modify my premise of a constant flat income tax of 50% and assume a different tax rate applies at retirement. If, at retirement, my income tax bracket is *lower* than the current 50%, the 401(k) would be even better. The $600 in my 401(k) account would result in *more* than $300 *after taxes*.

Suppose, at retirement, my income tax bracket is *higher* than the current 50% rate. The 401(k) would be less advantageous than with the constant 50% rate. At retirement, the Service would take more than half of my 401(k). I would have less than $300 left.

This lower amount might or might not be less than the non-401(k) (extra-salary) alternative: $300 *minus* the taxes on the income generated on the account. In other words, despite a *higher* tax bracket at retirement, the 401(k) alternative sometimes would still be better.

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Earlier, I assumed a constant flat tax rate of 50%. If I assume a different constant flat tax rate, the conclusion is the same. For example, if the constant tax rate is 30%, the $200 401(k) is in effect two accounts, a $60 account “owned” by the Service, plus a $140 account “owned” by me that generates no tax as it grows. Instead, if I take $200 of salary, I immediately pay $60 in income tax and have a $140 account that I own outright but that generates taxable income.

This article does not discuss the advantages of the Roth 401(k) or Roth IRA versus a traditional 401(k). That is the subject of another article of mine, *Some Immediate and Long-Term Advantages of a Roth IRA Conversion*, NewsQuarterly, Winter 2011, at 10. Nevertheless, another advantage of the traditional 401(k) is the eventual ability to convert either to a Roth 401(k) or a Roth IRA (depending on various circumstances, *e.g.*, change in employment, reaching a certain age, or employer policy). ■

The U.K. Windfall Profits Tax Circuit Split: A Unanimous Resolution . . . by Waiver?

By Matthew R. Sontag*

In 2011 and 2012, the Third and Fifth Circuits rendered diametrically opposed decisions on the creditability of the U.K. Windfall Profits Tax. *Compare PPL Corp. v. Commissioner*, 665 F.3d 60 (3d Cir. 2011) *with Entergy Corp. v. Commissioner*, 683 F.3d 233 (5th Cir. 2012). Less than one year after its creation, this split has been resolved in favor of creditability by a facially unanimous decision of the Supreme Court. However, in a concurring opinion, Justice Sotomayor makes clear that the rationale for the decision was less universal among the members of the Court than the ruling would suggest, but that the significant points of contention were effectively waived by the Commissioner. Her opinion leaves a crack in the door for future challenges of foreign tax credits in similar situations, should the Service ever find the desire to step through.

The U.K. Windfall Profits Tax

The two cases creating the circuit split resolved by the Supreme Court opinion address the U.K. Windfall Profits Tax, a tax nominally on “value,” enacted in the wake of the privatization and subsequent exponential profit growth of 32 previously-state-run British enterprises. The Windfall Profits Tax was technically imposed upon the difference between “profit making value” and flotation price, with “profit making value” calculated based on the actual profits earned by a given company during a base period—for 27 of the 32 taxpayers to which the tax applied, the four years immediately following privatization. The calculation as enacted could be mathematically reformulated to become an incremental 52% surtax on after-tax annual profits in excess of the profits that would have been earned at a flotation-price-to-earnings ratio of nine.

The Tax Court Opinion

Both cases were initially resolved by a single Tax Court opinion issued September 9, 2010, and finding in favor of a claim of creditability by PPL. *PPL Corp. v. Commissioner*, 135 T.C. 304 (2010). The same rationale was applied without further discussion to Entergy on the same day. *Entergy v. Commissioner*, T.C. Memo 2010-197, 100 T.C.M. (CCH) 202 (2010).

In reaching its conclusions, the Tax Court analyzed the U.S. federal income tax rules that, for a foreign tax to be creditable, it must be an “income, war profits, or excess profits tax” as those terms are used in the statute. *See* I.R.C. § 901(b)(1). To meet this standard, a levy must have “the predominant character” of an “income tax in the U.S. sense,” satisfying the realization, gross receipts, and net income tests defined under the regulations. *See* Treas. Reg. § 1.901-2(a)(3)(ii), -2(b)(1). As would become central to the Supreme Court discussion, a tax “either is or is not an income tax, in its entirety, for all persons subject to the tax.” Treas. Reg. § 1.901-2(a)(1).

In opposing creditability, the Service argued that the intention behind, and the history of, the Windfall Profits Tax were irrelevant to the analysis, and that any purported tax must be examined based exclusively on its literal statutory text. The Commissioner concluded that the Windfall Profits Tax met none of the realization, gross receipts, or net income tests, and was therefore not creditable. *See PPL*, 135 T.C. 330–32.

The Tax Court, agreeing instead with the taxpayers, looked to the intent and

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history of the statute as central to determining its "predominant character," and the Windfall Profits Tax, against such background, ultimately met each of the three tests. The Tax Court therefore held the tax creditable to all taxpayers. *Id.* at 342.

The Commissioner, unconvinced, immediately appealed the Tax Court ruling to the circuit courts, the Third Circuit for PPL (a Pennsylvania corporation) and the Fifth Circuit for Entergy (a Texas corporation).

The Third Circuit Opinion

The Third Circuit agreed with the Commissioner and reversed the Tax Court ruling in favor of PPL. *PPL Corp.*, 665 F.3d at 67–68. Refusing to reformulate the tax or consider its background or intent, the Third Circuit concluded that the Windfall Profits Tax, with its use of the "flotation" and "profit-making" values of the companies against which it was imposed, was, and *could only be*, a tax on *value*. *Id.* at 65.

In so concluding, the court stated that any possible reformulation would still necessarily fail the gross receipts test, given that the Windfall Profits Tax imposed a levy on a multiple of any given year's gross receipts. *Id.* at 67–68. The Third Circuit found that a reformulation that eliminated a gross-receipts-multiplier "read the gross receipts requirement out of the Regulations." *Id.* at 67. Looking to Example 3 in regulation section 1.901-2(b)(3)(ii), an example later explicitly analyzed by the Supreme Court, the Third Circuit saw no distinction between the levy in the example, noncreditable because the tax rate was imposed on 105% of fair market value of sold product, and the Windfall Profits Tax. Based on this, the Third Circuit rejected the creditability of a levy imposed on an amount greater than actual gross receipts, even if the calculation could be restated to apply a higher rate only upon actual gross receipts.

The Fifth Circuit Opinion

Just six months after the Third Circuit's decision, the Fifth Circuit reached the opposite conclusion, embracing the taxpayer's arguments and sustaining creditability. *Entergy*, 683 F.3d at 236. Though "chary to create a circuit split," that court nonetheless resoundingly rejected the rationale of the Third Circuit as "exemplif[ying] the form-over-substance methodology that the governing regulation and case law eschew." *Id.* at 237. The Fifth Circuit did analyze the issue of the Windfall Profits Tax base being facially greater than actual gross receipts. However, unlike the Third Circuit, the Fifth Circuit declined to read the 9/4ths multiplier in the Windfall Profits Tax as increasing actual gross receipts to a notional amount, instead implicitly concluding that the 9/4ths multiplier just adjusted the tax rate. *Id.* at 238.

The Supreme Court Opinions

The Supreme Court granted certiorari in *PPL* on October 29, 2012. Oral arguments were held on February 20, 2013, with the opinion in favor of creditability released May 20, 2013. *PPL v. Commissioner*, 2013 WL 2149792.

The Majority Opinion

In its opinion, the Court revisits the background and facts of the enactment of the Windfall Profits Tax, and briefly summarizes the history of litigation to that point. Then, Justice Thomas, writing for a nominally unanimous court, resoundingly rejects a formalistic application of the law and regulations in favor of a much more "commonsense approach." *PPL*, 2013 WL 2149792, at *2.

In his opening paragraph, Justice Thomas boldly declares that, "Consistent with precedent and the Tax Court's analysis below, we apply the predominant character test using a commonsense approach that considers the substantive effect of the tax." *Id.* This approach runs parallel to the approach of the Fifth Circuit in *Entergy*, and clearly contrary to the formal reading followed by the Third Circuit.

In analyzing the Windfall Profits Tax, Justice Thomas looks to the "normal manner in which [it] applies." *Id.* at *4. Based on his reading of the regulation and the case law that it codifies, it is irrelevant that a tax "may affect a handful of taxpayers differently." Instead, creditability is determined based on the manner in which the tax applies to the majority of taxpayers subject to it. *Id.*

Justice Thomas also concludes that "the way a foreign government characterizes its tax is not dispositive," concluding instead that "the crucial inquiry is the tax's economic effect." *Id.* Reformulating this view, he then states that "foreign tax creditability depends on whether the tax, if enacted in the U.S., would be an income, war profits, or excess profits tax." *Id.*

Justice Thomas then analyzes the two fundamental arguments presented to the lower courts—that the Windfall Profits Tax could be reformulated to be a tax on income, or that it was facially (and therefore conclusively) a tax on value. Ultimately, he rejects the argument that it was a tax on value, though for reasons different from those of the Fifth Circuit or the Tax Court. In his view, "the Labour government's conception of 'profit-making value' as a backward-looking analysis of historic profits is not a recognized valuation method; instead, it is a fictitious value calculated using an imputed price-to-earnings ratio." *Id.* at *5. To his mind, it then follows that "the windfall tax is a tax on realized net income disguised as a tax on the difference between two values, one of which is completely fictitious." *Id.*

Justice Thomas then steps through the reformulation that has become the core of this dispute, using algebra to again reach a tax imposed on previously earned net profits at approximately 52%. He concedes that other reformulations

are possible, but places the emphasis not on the specific formula used, but on the "economic substance of the tax and its interrelationship with net income" demonstrated by the ability to reformulate the tax at all. *Id.* at *6. Ultimately, he rejects the "rigid construction" of the Commissioner, that the U.K. government's characterization of the tax as one on value is binding, as "unwarranted." *Id.* at *7. He finds that such a conclusion "cannot be squared with the black-letter principle that 'tax law deals in economic realities, not legal abstractions.'" *Id.* (quoting *Commissioner v. Southwest Exploration Co.*, 350 U.S. 308, 315 (1956)). Applying "substance over form," Justice Thomas concludes, "the windfall tax is nothing more than a tax on actual profits above a threshold." *Id.*

Justice Thomas also looks at the same Example 3 from the Regulations so focused on by the Third Circuit, which denies creditability to a tax imposed on 105% of gross receipts, but interprets the example very differently. First, he concludes that the example is inapplicable, focusing as it does on a nominal amount of receipts, whereas the Windfall Profits Tax is based fundamentally on a known amount of receipts. Second, the example discusses gross receipts, unreduced by expenses, rendering the tax noncreditable under the net income test. Finally, the example suggests that gross receipts are inflated but that expenses are not, resulting in a failure to recover all significant receipts. Under all three theories, Justice Thomas finds the example not to apply to the Windfall Profits Tax.

Ultimately, Justice Thomas, joined by a unanimous court, finds the U.K. Windfall Profits Tax creditable.

Justice Sotomayor's Concurrence

Justice Sotomayor also wrote an unusual concurring opinion, discussing an argument raised by an amicus brief that, by implication, would have led to a dissenting opinion but was rejected by the government itself during the course of litigation. This argument focuses on the Windfall Profits Tax not as applied to the majority of taxpayers, but as to the outlier taxpayers. These outliers were disregarded by all parties to the litigation, all lower courts, and Justice Thomas in the majority opinion. However, in the view of Justice Sotomayor, in accordance with one of the amicus briefs received by the Court, in certain circumstances the "outliers" become critical to understanding the true nature of a foreign levy.

Justice Sotomayor readily agrees that, if one ignores the "outlier" taxpayers, "it appears to follow that the windfall profits tax can properly be characterized as an excess profits tax." 2013 WL 2149792, at *10 (Sotomayor, J., concurring). However, by examining the outlier taxpayers, she concludes that "seen through this lens, the windfall tax is really a tax on average profits." *Id.* In her view, imposing a charge on average profits "is not how an income tax works." *Id.* Instead, given that average daily profits multiplied by a price-to-earnings ratio is a method of approximating value, it becomes clear to her that the Windfall Profits Tax is more a tax on value. In Justice Sotomayor's view, then, these few taxpayers affected differently by the Windfall Profits Tax "are not random outliers . . . but instead are critical pieces of data for understanding how the tax actually functioned as a matter of 'economic realit[y].'" *Id.* at *11 (quoting *Commissioner v. Southwest Exploration Co.*, 350 U.S. at 315).

However, Justice Sotomayor concedes that this argument only succeeds if a tax must function as an income tax for all taxpayers—if the tax may apply as a tax on value to some but as an income tax to most and still be creditable, the argument dies. *Id.* Further, she references the government's failure to pursue the argument she presents. Thus, as she states in her closing sentence, "while I find this argument persuasive, I do not base my analysis of this case on it and therefore concur in the Court's opinion." *Id.*

Conclusion

It appears from Justice Sotomayor's "concurring" opinion that the government could have converted her voice to a dissent had they embraced the outliers and presented them as evidence against creditability. The government, though perhaps not realizing the full impact, chose not to do so. It thus remains an open question what would happen if a future case were to be brought relying not on the majority but on the outliers—and whether Justice Sotomayor's concurrence would produce enough "authority" to sway a lower court's decision in such future case.

In any event, the controversy surrounding creditability of the U.K. Windfall Profits Tax has finally been put to bed by nine votes to none, even if one of those votes was somewhat ambiguous in her true support for the Court's decision. ■

Irrevocable Life Insurance Trusts: An Effective Estate Tax Reduction Technique (Part 1)

By Adam Abrahams*

This two-part article addresses irrevocable life insurance trusts as a method for reducing the estate tax. Part 1 covers estate and income tax issues. Part 2, to be published in a subsequent issue, will cover gift and generation skipping transfer tax issues.

The Liquidity Problem

Many individuals, when contemplating their estate planning, want to avoid liquidity problems in paying for their funeral expenses, estate or trust administrative expenses, federal and state estate taxes, inheritance tax (where applicable), and debts. Perhaps most if not all of the assets are illiquid (for example, a closely-held business), or they would be subject to tax if reduced to cash (for example, IRAs or other retirement plans). The client may want surviving family members to continue the business or may want to maximize post-death income tax deferral. Or he may own real estate that is "underwater," and thus the estate cannot liquidate the real estate in order to pay any estate expenses.

Most people purchase term or cash value policies insuring their lives, separately or together with their spouses, to provide a nest egg for their loved ones and so that their estates can promptly obtain funds to pay any expenses and taxes. If the insured owns the policy or transfers ownership to the spouse outright, these purposes are compromised. An increase in the gross estate (insured's estate or spouse's estate), ultimately increases liquidity needs for federal and state estate tax purposes.

To determine if a decedent's estate is subject to estate tax, one must first determine the value of the gross estate. I.R.C. § 2031. What many people often do not realize is that the gross estate includes amounts receivable by the estate's executor/personal representative as insurance under policies on the life of the decedent. I.R.C. § 2042(1). The gross estate also includes amounts receivable by other beneficiaries of those insurance policies if the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. I.R.C. § 2042(2).

Some individuals may not elect or may neglect to purchase life insurance or may allow policies to expire. They may believe that the surviving family members can liquidate the successful business to pay any estate expenses or that the business will have enough cash or liquid assets to satisfy any debt. This creates additional problems. The sale of substantial business assets may severely affect the ability to continue the business. In addition, potential income tax issues arise on the sale of business assets. They may have underestimated the estate expenses, thus overestimating the cash available to pay such expenses.

An Effective Solution: An Irrevocable Life Insurance Trust (ILIT)

What Is an ILIT?

An ILIT is a trust primarily designed to hold life insurance. Because it is irrevocable, the grantor cannot change or terminate it. The ILIT's trustee is the policy's owner and beneficiary. The ILIT's terms determine who ultimately receives the policy proceeds. At the insured's death, the policy proceeds are paid to the trust. An ILIT removes the life insurance proceeds from the gross estate, thus reducing the taxable estate.

An insured creates an inter vivos trust with a trustee other than himself. The insured may transfer an existing insurance policy or policies to the trust or a sufficient amount of cash for the trustee to purchase a new insurance policy.

Transfers to irrevocable trusts usually do not qualify for the $14,000 annual gift tax exclusion and therefore are subject to gift tax. However, this exclusion is available if the ultimate beneficiaries are given a limited right of immediate withdrawal from the trust, as discussed below. If the beneficiary is a minor, a parent or legal guardian (other than the grantor) can exercise that beneficiary's rights. If the named beneficiaries do not exercise their withdrawal rights within the specified time period, the withdrawal rights lapse and the trustee has more funds available to pay the life insurance premiums.

At the insured's death, the trustee collects the policy proceeds from the life insurance company. If the estate of the grantor-insured needs cash to pay estate taxes or debts of the estate, the ILIT trustee has various options. The trustee could buy assets from the estate for cash. This provides liquidity for the estate and allows the purchased assets to pass to the trust beneficiaries. The trustee could also lend cash to the personal representative of the estate (and to a trustee of any revocable living trust). The estate would repay the loan upon the sale of estate assets or would distribute the assets subject to the loan.

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Why Is an ILIT Useful?

An ILIT is a useful estate planning tool because it avoids federal estate tax on assets passing that do not qualify for a charitable or marital deduction. If the insured transfers an existing policy into an ILIT, he must survive a minimum of three years from the date of transfer to avoid any inclusion of the policy in his gross estate. I.R.C. § 2035(a). If he does, an ILIT can increase the amount of assets passing to beneficiaries without increasing the estate tax. In effect, the insured can establish an ILIT without using any estate tax exemption equivalent of either spouse.

ILITs can immediately provide liquidity for the decedent's estate and estate beneficiaries. They can be used to fulfill family plans to provide education, support and maintenance for beneficiaries after the death of the insured. Testamentary trusts can provide similar benefits. However, a testamentary trust does not provide the same protection from estate taxes as an ILIT.

An ILIT is generally not subject to creditors' claims against the insured's estate. Neither an ILIT beneficiary nor a creditor of a beneficiary has a right to demand a distribution from the trust or the right to attach a beneficiary's interest in the trust. The trustee could also use trust assets to pay a beneficiary's expenses directly, for example, making car payments, rather than distributing cash that would be subject to claims of the beneficiary's creditors. The ILIT could also purchase a car for use by a beneficiary. Because the ILIT owns the car, the asset is protected from the beneficiary's creditors.

An ILIT can provide beneficiaries with special powers to appoint property to family members or charities during their lifetime or at death. ILITs can also provide beneficiaries with the power to withdraw funds up to 5% of the trust principal without incurring any possible transfer tax. Beneficiaries or an independent trustee can change trustees. An independent adviser (sometimes called a trust protector) can also change grantor trust status, change trust situs, terminate the trust, or keep the trust in compliance with any state law pertaining to trusts or any federal or state tax laws. The ILIT may also contain flexible investment and distribution provisions, including the choice of other professional advisers.

Typical ILIT Terms and Provisions

An ILIT typically provides a temporary "spray" of income and principal to the insured's spouse and descendants as discretionary distributees. (Some forms provide for no distributions during the insured's life, because the intent is for the policy to accumulate to maximize the death benefit, but that ignores the possibility that the policy might be cashed in or sold.) Unless the trustee is independent, the trustee's discretionary power to use income or principal should be limited to an ascertainable standard. Section 2041(b)(1) provides that, for purposes of section 2041(a), the term general power of appointment means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate. It does not include a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent. *See also* Treas. Reg. § 20.2041-1.

The ascertainable standard generally pertains to distributions for the health, education, support or maintenance of a trust beneficiary. Treas. Reg. § 20.2041-1(c)(2). The terms "support" and "maintenance" are synonymous, and their meaning is not limited to bare necessities. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary must exhaust his other income before the power can be exercised. The regulations also provide that clauses such as "support in reasonable comfort" and "support in his accustomed manner of living" are limited by the requisite standard. Courts generally have permitted the ascertainable standard to include the accustomed manner of living when they can make a concrete determination about the beneficiary's prior living situation. Treas. Reg. § 20.2041-1(c)(2). *See also Estate of Chancellor v. Commissioner*, T.C. Memo. 2011-172.

An ILIT should expressly state that it is irrevocable. Typical trustee provisions include a statement that the trustee shall be the absolute owner of all insurance policies held by the trust, a statement relieving the trustee from the duty to file a lawsuit to enforce payment of premiums without indemnification, a statement that the insured is not obligated to enter into any covenant to keep any insurance policies in force, and a statement empowering the trustee to loan or purchase estate assets. This provides liquidity for a decedent's estate.

Potential Estate Tax Pitfalls

The settlor must not list the estate's personal representative as the beneficiary of the ILIT. Otherwise, any life insurance proceeds are included in the gross estate of the decedent-insured and subjected to claims of the decedent's creditors. I.R.C. § 2042(1). Policy proceeds cannot be paid to any beneficiary subject to a legally binding obligation to pay expenses of a decedent's estate. Treas. Reg. § 20.2042-1(b). Such expenses include an obligation to pay any taxes or debts. An ILIT can still authorize a trustee to loan any proceeds to the insured's estate or to purchase assets from the estate without triggering estate tax. *Old Colony Trust Co. v. Commissioner*, 39 B.T.A. 871, 879 (1939). The power to loan or purchase should only be a discretionary tool and not a required duty of a trustee. Treas. Reg. § 20.2042-1(b)(1).

If a decedent possessed any incidents of ownership, the policy proceeds are

included in the gross estate. Treas. Reg. § 20.2042-1(b)(1). The regulations define incidents of ownership as an insured having sole or co-power to obtain a loan, pledge the policy for a loan, surrender or cancel the policy, change the policy beneficiary, assign the policy, or revoke or veto an assignment made by the owner of the policy. Treas. Reg. § 20.2042-1(c)(2). *See also* TAM 9128008 (holding that the right to repurchase a policy from an assignee was the equivalent of a right to revoke the assignment and was thus an incident of ownership). Incidents of ownership include power over choice of settlement options, power to change beneficial ownership, or power to surrender the policy. Treas. Reg. § 20.2042-1(c)(4). A 5% or greater reversionary interest is an incident of ownership. I.R.C. § 2042(a); Treas. Reg. § 20.2042-1(c)(3).

Income Tax Issues

Life insurance contract proceeds received upon the death of an insured are generally excluded from gross income. I.R.C. § 1.101(a)(1); Treas. Reg. § 1.101-1(a)(1). Income tax issues could nevertheless arise over transfer for value questions, potential gain to the policy owner, failure of a beneficiary to exercise the right of withdrawal, and power of substitution of assets of equal value.

Transfer for Value

Under the transfer for value rules, a transfer or sale of a life insurance contract for valuable consideration could make the death benefit's exclusion from income tax unavailable. I.R.C. § 101(a)(2); Treas. Reg. § 1.101-1(b). Amounts excluded from income include the actual value of consideration, premiums, and other amounts such as interest. I.R.C. § 101(c). *See also* Treas. Reg. § 1.101-1.

The Service considered the transfer for value limitation of section 101(a)(2) in the context of one ILIT selling a policy to another ILIT. Rev. Rul. 2007-13, 2007-11 I.R.B. 684. The Service has ruled that a grantor who is treated for federal income tax purposes as the owner of both ILITs is treated as the owner of the contract for purposes of applying any transfer for value limitations under section 101(a)(2), because there is no "transfer" of the contract within the meaning of such code section. *Id.*

Potential Gain to Policy Owner—Use of a Grantor Trust

If the ILIT is a grantor trust under sections 671 through 677, the grantor-insured is taxed on trust income and loss. ILITs will qualify as grantor trusts if income may be distributed to or accumulated for the grantor's spouse, or may be used to pay life insurance premiums. I.R.C. § 677(a). The Service has approved using a swap power to create grantor trust status when insurance is involved, without causing section 2036 or section 2042 to apply. I.R.C. § 675(4)(C). *See also* Rev. Rul. 2011-28, 2011-49 I.R.B. 830.

For an unfunded ILIT that produces no income, it is irrelevant whether the ILIT is a separate tax entity or a grantor trust. Funded ILITs (front-end loaded to pay premiums or owning other assets used to purchase a policy) have potential income tax ramifications, however. A grantor's payment of income tax on trust income attributable to a grantor under the grantor trust rules does not constitute a gift from the grantor to the ILIT. Rev. Rul. 2004-64, 2004-27 I.R.B. 7. However, trust provisions requiring the ILIT to reimburse a grantor for the payment of income tax cause the full value of the ILIT's assets to be includible in a grantor's gross estate. Treas. Reg. § 20.2036-1(b)(2).

There may also be issues for beneficiaries from lapsed *Crummey* powers. Any grantor of a grantor trust is subject to income tax, notwithstanding the existence of any *Crummey* power, however. I.R.C. § 678(b). *See also* PLR 200949012.

Failure of Beneficiary to Exercise Right of Withdrawal

The annual lapse of the ILIT beneficiary's right of withdrawal (or general power of appointment) may create income tax problems for the beneficiary in the context of the grantor trust rules. A beneficiary may be deemed to be the permanent owner of any portion of the ILIT if the beneficiary has released a power solely exercisable by the beneficiary to receive principal or income of the ILIT. I.R.C. § 678(a)(2).

If the beneficiary is eligible to receive trust income without any consent of an adverse party, the beneficiary may be subject to income tax pro rata on the lapsed portion of trust property. I.R.C. §§ 677(a) & 678(a)(2). *See also* PLR 200022035. It does not matter if the beneficiary actually receives the income. *Id.* Also, the "5 and 5" exception for lapsed powers for estate and gift tax does not apply to the grantor trust rules. PLR 200022035. Finally, there may be income tax exposure if the ILIT earns income after the death of the grantor-insured.

Power of Substitution of Assets of Equal Value

An ILIT may also include a power to substitute assets of equivalent value if one has non-fiduciary powers exercisable without the consent of a fiduciary. Regarding estate tax liability, the grantor-insured may substitute life insurance policies of equal value for those owned by the ILIT without causing inclusion in the gross estate. Rev. Rul. 2011-28, *supra*. A trustee may elect to trade a high basis or high cost asset (thus taking that asset out of the ILIT) for a low basis or low cost asset without any step-up in basis (thus the ILIT owns the low basis asset) to reduce a grantor-insured's income tax.

Revenue Ruling 2011-28 clarifies issues regarding the trustee power of substitution of a life insurance policy. A grantor's power to acquire an insurance policy held in a trust by substituting

other assets of equal value will not cause inclusion of the policy in the grantor's gross estate under section 2042, as long as certain guidelines are met. This is significant because section 2042 includes as a taxable asset in one's gross estate any share of life insurance proceeds to which the decedent possessed at the decedent's date of death any incidents of ownership in the policy, exercisable either alone or in conjunction with any other person.

Conclusion

ILITs are an excellent estate planning tool for decedents whose estate assets consist primarily of an ownership interest in a business, including real estate development. This tool is available in the event the estate lacks liquidity for paying estate taxes and other estate administrative expenses. This option allows a decedent's family or successors to continue the business.

ILITs also serve as an effective estate planning option where one's sole liquid assets consist of retirement accounts. If the estate withdraws funds from a retirement account to pay estate taxes or other estate expenses, the estate is also subject to income tax caused by the withdrawal. An ILIT alleviates the effects of this potentially catastrophic tax consequence (income and estate tax in the same year) by loaning money to an estate to pay estate tax. ■

CLE CALENDAR

ABA Section of Taxation CLE Calendar

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

DATE	PROGRAM	CONTACT
August 28, 2013	**The ABCs of Summons Enforcement Including Recent Developments CLE Webinar and Teleconference**	Tax Section www.americanbar.org/tax 202.662.8670
September 26-27, 2013	**Health and Welfare Benefit Plans 2013** The Ritz-Carlton Pentagon City – Arlington, VA	ABA JCEB www.americanbar.org/jceb 202.662.8670
October 16-18, 2013	**ERISA Basics National Institute** Westin Chicago River North – Chicago, IL	ABA JCEB www.americanbar.org/jceb 202.662.8670
October 17-18, 2013	**ALI CLE Course of Study: How to Handle a Tax Controversy at the IRS and in Court** Washington Marriott – Washington, DC	ALI CLE www.ali-cle.org 800.CLE.NEWS
November 6-7, 2013	**24th Annual Philadelphia Tax Conference** Union League of Philadelphia – Philadelphia, PA	Tax Section www.americanbar.org/tax 202.662.8670
November 14-15, 2013	**ALI CLE Course of Study: Tax Exempt Organization**s The Ritz-Carlton Pentagon City – Arlington, VA	ALI CLE www.ali-cle.org 800.CLE.NEWS
March 31-April 1, 2014	**2014 ABA/IPT Advanced Income Tax Seminar** The Ritz-Carlton New Orleans – New Orleans, LA	Tax Section www.americanbar.org/tax 202.662.8670
April 1-2, 2014	**2014 ABA/IPT Advanced Sales/Use Tax Seminar** The Ritz-Carlton New Orleans – New Orleans, LA	Tax Section www.americanbar.org/tax 202.662.8670
April 3-4, 2014	**2014 ABA/IPT Advanced Property Tax Seminar** The Ritz-Carlton New Orleans – New Orleans, LA	Tax Section www.americanbar.org/tax 202.662.8670
April 9-11, 2014	**14th Annual Tax Planning Strategies – U.S. and Europe** Geneva, Austria	Tax Section www.americanbar.org/tax 202.662.8670
June 4-6, 2014	**7th Annual U.S. – Latin America Tax Planning Strategies** Mandarin Oriental Hotel – Miami, FL	Tax Section www.americanbar.org/tax 202.662.8670

In Ana Cecilia's own words …

NQ What made you first apply for the Fellowship?

ACL I recently spoke with a woman who said that someone from social services had referred her to come see me. However, she had never talked to an attorney before and was intimidated to do so. She thought that her issue was not important enough to warrant the attention of an attorney. She went on to tell me that she had been afraid to call me in advance. I was not surprised. As a first generation immigrant to this country, I could relate to the feelings she described and recognize that most immigrants, and especially Latinos in this country, have similar experiences. I went to law school to address these issues.

When I applied to the Fellowship my main objective was to address the issues of "invisibility" and "self-editing" in the Latino population. Invisibility, because Latinos have occupied positions behind closed doors—dishwashers, cooks, roofers, after hour cleaning crews, domestic workers, etc. These workers are kept out of sight from the public, making them invisible to the rest of the population. This invisibility exacerbates the problems with self-editing. What I mean is the behavior in which the person decides that she does not qualify for a program or service before even applying for it. I saw the Fellowship as a perfect opportunity to address these issues.

By providing services in Spanish, I thought that I could truly engage my clients and explain their rights and responsibilities. I saw the potential for empowering people who have been underrepresented and/or misrepresented. But most importantly, I saw the potential to trigger social change. By educating taxpayers and small business owners, I sought to highlight their position in society as active and engaged participants.

NQ Tell us about the area your clinic serves.

ACL My office is located in Pasco, Washington. Here, the clinic serves lower-income individuals and small business owners, mostly Latino immigrants from the surrounding counties. Pasco's population is 63% Latino and Yakima, the neighboring county, is a little over 50%. In addition, Pasco has one of the highest percentages of poverty in the state—76%. This area houses large agricultural employers and many independent contractors doing construction work. These occupations pay minimum wage salaries or by piece work and are limited by the season. Many Pasco agricultural workers migrate to neighboring states in pursuit of agricultural work; therefore, services may begin in Pasco, but will continue to be provided as workers migrate. Pasco is about 3.5 hours from the closest metropolitan area to access services. I have several clients who live an hour away from Pasco and they are very happy to receive services.

Ana Cecilia Lopez

NQ How does your service area affect how your clinic operates?

ACL Because of the broad geographical area, I have partnered with several established agencies and private businesses to provide educational seminars. In addition, I am collaborating with the local radio station providing information to a wider audience. Many of my clients are referred to me through word of mouth and Spanish speaking accountants, CPAs, and other attorneys. I also rely on local economic development agencies and participate in as many teaching opportunities as possible. In addition, I have been a guest speaker in the Pasco school system's parent education program. Through this program, I am able to address participating parents, in Spanish, about important tax and business related matters. I teach introductory classes covering a variety of topics, from rights and responsibilities to business deductions, credits, and choice of entity for businesses. Because of the vast region served, most of the services must be provided by phone, fax, and mail.

NQ Can you give examples of the types of tax issues you deal with in providing tax assistance to low income taxpayers?

ACL My services range widely. I have prepared innocent spouse petitions and assisted clients with a variety of issues including tax return examinations, offers in compromise, collections assistance, tax return amendments, failure to file tax returns, disallowance of dependents, CTCs and EITCs.

With small businesses I provide education and direct representation. I spend time with each client giving them information about business issues such as permissible and impermissible deductions, employment tax and self-employment tax distinctions and responsibilities, and the difference between federal and state taxation. In addition, I assist them with properly designing, forming, and managing their small businesses—requesting business licenses, Employer Identification Number requests, registering with Washington revenue agencies, developing accounting systems, mileage logs, and exploring payroll system options.

NQ What has been your most rewarding experience as a Fellow?

ACL Educational presentation attendees are very thankful to receive the information. They may be interested in starting a business, or may already have one, but they were not aware of the many things they need to take into account. At these presentations, there is a true sense of empowerment and lifting of the community as a whole. This program provides information to those who have felt isolated for a long time. As a client told me recently, he is eager to start a business and he was starving for direction and information. After the presentation he felt a sense of direction for his next steps and how to get started. I see the hunger for knowledge in students and clients and being able to help them empower themselves is truly rewarding.

I am currently working with a client who is being audited. His biggest problem is that he has been operating informally for the past three years. He has no records or documentation. We are helping him formalize his business and become compliant with state and federal requirements. The client understands that he will have to pay fines and bring his payments current. However, this is the first time he has had access to business information in Spanish and is excited to take all the necessary steps to become a recognized and compliant Washington business. This process is very rewarding when I help clients shift their fears into the confidence needed to successfully run their businesses.

NQ What has been your biggest challenge in the position?

ACL The biggest challenge is changing people's perceptions about attorneys and the services we provide. Clients ignore issues until they become severe. At this point they have no choice but to seek help. Failure to act earlier costs money and opportunities. Too often people fail to access the right information or assistance in a timely manner. Because of lack of access and resources clients are forced to rely on non-attorneys to help them with legal documents that affect their rights and ultimately because they are not properly or timely prepared it has adverse consequences.

NQ Do you have any immediate plans after the Fellowship?

ACL In several counties in eastern Washington, the Latino population is now the majority. I plan to open a legal practice in Pasco, Washington, where I will continue to provide business and tax law services. Ideally I would like to secure funding to start a nonprofit organization and continue providing services to lower-income individuals, but expand services to include immigration law. I also recognize an emerging middle class among Latinos, and their need for services in Spanish; if I am unable to find funding for a nonprofit, I would like to assist paying clients with sliding fees, payment plans, and of course pro bono services. In addition, I will continue teaching business seminars and tax information for adults. I am in the process of coordinating with the local school district to teach business and tax law at the middle and high school level. ■

Since 2009, the Section has funded two Public Service fellows each year, including these amazing young lawyers (fellowship details are available at http://www.americanbar.org/groups/taxation/awards/psfellowship.html):

2009–2011
Laura Newland (AARP's Legal Counsel for the Elderly, Washington, DC; now the ABA Tax Section's Pro Bono Tax Counsel)
Vijay Raghavan (Prairie State Legal Services, Rockford, IL)

2010–2012
Douglas Smith (Community Action Program of Lancaster County, PA)
Katie Tolliver Jones (Legal Aid Society of Middle Tennessee and the Cumberlands, Nashville, TN)

2011–2013
Sean Norton (Pine Tree Legal Assistance, Inc., Portland, ME)
Anna Tavis (South Brooklyn Legal Services/Immigrant Workers' Tax Advocacy Project, New York, NY)

2012–2014
Ana Cecilia Lopez (University of Washington, Low-Income Taxpayer Clinic, Pasco, WA)
Jane Zhao (Center for Economic Progress, Chicago, IL)

2013–2015
Susanna Birdsong (National Women's Law Center, Washington, DC)
Susanna Ratner (SeniorLAW Center, Philadelphia, PA)

2012 Law Student Tax Challenge Bench Briefs

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 counseling competition designed to focus on the tax consequences of a complete 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. Because of space constraints, the discussion of these problems below condenses the extensive analysis, eliminates many of the citations to authority, and omits several issues. *NewsQuarterly* acknowledges the efforts of Ivan Golden and Shawn McIntire (LSTC co-chairs), Gary Scanlon and Julie Green (LL.M. division problem drafters), and Ben Schenker (chair) and the other members of the J.D. problem drafting committee. —*Gail Levin Richmond, Nova Southeastern University Law Center, Davie, FL*

LL.M. Problem

The 2012 LL.M. division problem involves a plan for Eternal Sunshine (ES), a cruise line that is incorporated in the U.S. and has recently filed for chapter 11 bankruptcy protection, to emerge from bankruptcy as Bermuda Bliss (BB), a corporation formed in Bermuda. BB will acquire the cruise assets of ES and continue its business. The problem is composed of 3 sub-problems: (1) whether section 7874(b) applies to treat BB as a U.S. corporation; (2) whether ES's sole shareholder and CEO (Bob) is entitled to a loss with respect to his ES stock; and (3) whether the ES debenture holders will likely approve the proposed emergence transaction based on their potential tax consequences. The analysis excerpted below covers only the first issue.

Students must first address whether, after the proposed transaction, BB will be treated as a U.S. corporation under section 7874(b). It is likely that section 7874(b) would apply to treat BB as a U.S. corporation, despite its legal incorporation in Bermuda. Section 7874 is intended to remove the incentives for entering into inversion transactions replacing a U.S. corporation or parent of a multinational corporate group with a foreign corporation or parent. In the case of an inversion transaction that involves 80% or greater identity of stock ownership before and after the transaction, the statute accomplishes this by disregarding the inversion and treating the foreign parent as a U.S. corporation for all purposes of the code.

BB will be treated as a U.S. corporation if three conditions are satisfied: (1) BB has acquired substantially all of the assets of ES (the substantially all test), (2) BB is owned 80% or more by former shareholders of ES by reason of their ownership in ES (the ownership test), and (3) BB does not have substantial business activities in Bermuda immediately after the acquisition of ES's assets (the lack of substantial business activities test).

Substantially All Test

This test is satisfied if BB acquires substantially all of the properties of ES. In the proposed transaction, BB will purchase all of the cruise assets of ES, worth $700 million, for cash and BB stock. Shortly after filing for bankruptcy (and before the proposed transaction), ES sold $400 million of investment property for cash, which will be distributed to its creditors under the proposed plan. Although the specific requirements of this test are not clear under the Code and regulations, it is likely satisfied because all of the ES core operating assets will be acquired. In the absence of guidance, using the substantially all standards applied to section 368 reorganizations is reasonable, particularly given that inversion transactions are frequently accomplished through such reorganizations.

The substantially all standard of section 368(a)(1)(C) and (D) is satisfied for purposes of obtaining a letter ruling if there is a transfer of assets representing at least 90% of the fair market value of the net assets and at least 70% of the fair market value of the gross assets held by the corporation immediately prior to the transfer. Rev. Proc. 77-37. Pursuant to the emergence plan, BB will acquire all of the cruise assets of ES and so it appears to meet the 70% minimum threshold for the transfer of gross assets. However, in determining whether the test is satisfied, the sale of the beach-front property owned by ES to an unrelated party should be considered. In Rev. Rul. 88-44, the Service addressed whether a pre-reorganization disposition of 50% of a corporation's historic business assets caused the subsequent transaction to fail the substantially all standard of section 368(a)(1)(C). The ruling makes it clear that what constitutes substantially all depends on the facts and the circumstances of each case. In that ruling, the Service found that the substantially all requirement was met notwithstanding the sale because the (1) sale was to an unrelated party and (2) the sale proceeds were transferred along with the remaining 50% of the assets to the acquiring corporation. Here, however, the cash proceeds were distributed to the creditors pursuant to the reorganization, rather than transferred to the acquiring corporation. Thus, the Service probably could not

argue that the test is met under the replacement asset theory of Rev. Rul. 88-44. Rather, it would have to argue, and would likely prevail, on the theory that the sale of the beachfront property should be accorded little weight because it was a non-core asset.

Whether a corporation has transferred substantially all depends on the quantum and quality of the property to be transferred. There is no particular percentage that is controlling in all cases, but rather "the nature of the properties retained by the transferor, the purpose of retention and the amount thereof" are all relevant to the determination. Rev. Rul. 57-518. Thus, when the properties not acquired by the acquiring corporation consist primarily of non-operating assets, a lower percentage of overall assets acquired may satisfy the substantially all requirement. *See*, *e.g.*, *James Armour, Inc. v. Commissioner*, 43 T.C. 295 (1964) (51% of the assets, consisting of all of the operating assets); *Smothers v. United States*, 642 F.2d 894 (5th Cir. 1981) (15% of total assets; remaining assets were non-operating). This is particularly true in the context of D reorganizations, with respect to which the Service argued for a lower standard to combat a perceived taxpayer abuse. Because section 7874 is likewise an anti-abuse rule, it is likely that a court applying this test will seek guidance from authorities interpreting substantially all in the context of D reorganizations.

Although the rental property represents one third of the ES gross assets, it is likely that substantially all has been transferred to BB because the real property did not constitute core operating assets of ES. Accordingly, it is likely that the proposed transaction satisfies the substantially all test.

Ownership Test

This test is met if, after the acquisition of the ES property, at least 80% by vote or value of the BB stock is held by former ES shareholders by reason of their holding ES stock. In the first step of the proposed transaction, Bob will form Bermuda Bliss as a new Bermuda corporation and will receive its common stock in exchange for his contribution of $600,000. When ES liquidates in a later step, the bondholders will receive BB stock and cash in cancellation of their claims against ES, and the shareholder's ES stock will be extinguished for no consideration. The final structure has Bob owning 66.7% and the former creditors owning 33.3% of the BB stock. As discussed below, BB should treated as being 100% owned by former shareholders of ES solely because of the bondholders' continued interest in BB. Accordingly, the ownership test condition should be satisfied.

The BB stock received by Bob is not by reason of his prior ownership of stock in ES and should therefore be disregarded for purposes of the test. A former shareholder of a domestic corporation owns stock of a foreign corporation by reason of holding stock in the domestic corporation if he received the foreign corporation stock in exchange for, or with respect to, stock in the domestic corporation. Treas. Reg. § 1.7874-2(f). Although the regulation is clear that the condition may be satisfied other than through exchanges or distributions, his receipt of stock will likely not meet this definition of the by reason of condition. Specifically, he did not receive the BB stock in exchange for, or with respect to, his stock in ES, but rather in exchange for the cash contributed.

One could argue that despite the fact that he contributed cash to receive his BB shares, his status as the sole shareholder of ES, the predecessor to BB, made him an insider that somehow entitled him to the shares of BB. However, in an analogous context, at least one court has rejected this argument. *Delk v. Commissioner*, 113 F.3d 984 (9th Cir. 1997).

While *Delk* supports the view that he should not be viewed as having received the BB by reason of his ES stock, and thus should not be included in the numerator of the ownership fraction, his ownership in BB should also not be taken into account in the denominator (*i.e.*, as having been received by a non-shareholder). In Notice 2009-78, the Service indicated its intention to publish regulations identifying situations in which stock is not taken into account for purposes of the ownership condition in section 7874(a)(2)(B)(ii). Under the regulations, which will apply to transactions completed on or after September 17, 2009, stock issued in exchange for cash should not be included in either the numerator or denominator of the ownership percentage calculation. Thus, for purposes of the ownership test, Bob's BB stock should be wholly disregarded.

The BB stock received by the ES creditors will be treated as stock held by former ES shareholders, thus causing the test to be satisfied. For purposes of the anti-inversion rules, creditors of a domestic corporation are considered shareholders of the corporation, and their claims are treated as stock of the corporation, if immediately before the acquisition of its properties, (1) the corporation is in federal bankruptcy proceedings, or (2) its liabilities exceed the value of its assets. Treas. Reg. § 1.7874-2(i)(2). The regulations specifically state that a creditor treated as a shareholder of the corporation under this rule is treated as a shareholder for all purposes of section 7874, specifically including section 1.7874-2(f), which defines the by reason of condition. Stock in a foreign corporation received in an inversion transaction by creditors of a corporation in bankruptcy in exchange for their claims will therefore be treated as held by reason of equity in the domestic corporation.

ES has filed for chapter 11 bankruptcy protection and so, under section 1.7874-2(i)(2), the bondholders should be treated as shareholders of ES immediately before the transaction. Because they undoubtedly received stock of BB in exchange for their bonds

pursuant to the emergence plan, they will hold the BB stock by reason of their former interests in ES. Thus, disregarding Bob's interest in BB under Notice 2009-78, 100% of the equity of BB should be viewed as owned by former ES shareholders by reason of their ES stock. Accordingly, it is likely that the proposed transaction satisfies the ownership test.

Lack of Substantial Business Activities Test

This test is satisfied if, immediately after the acquisition of ES's assets, BB does not have substantial business activities in Bermuda when compared to its total business activities. Because most of the revenue and employees are in Bermuda, the problem directs the analysis of substantial business activities towards the location of the corporation's assets, which include cash, rented facilities and offices, and four cruise ships (Baby Buoy, Sail Me Maybe, Lady Gangway, and Pink Float). Taking into account the location of its assets, BB will likely satisfy this test (*i.e.*, BB will not have substantial business activities in Bermuda).

Under section 1.7874-3T, BB has substantial business activities in Bermuda only if BB has at least 25% of its worldwide revenue, employees, and assets located in Bermuda. Failure to meet the threshold test for any one of these categories will mean that BB does not have substantial business activities in Bermuda for purposes of section 7874. As the problem indicates, most of BB's revenue is derived in Bermuda. Therefore, students should assume that the revenue-prong of this test is satisfied.

Likewise, the problem indicates that most of BB's employees are located in Bermuda. However, the 25% threshold must be applied to both employees by compensation and by headcount. The students might, therefore, note that whether the employee-prong of the test is satisfied cannot be determined without more information. Indeed, it is possible that, although most employees are located in Bermuda (and thus, by headcount, BB may have sufficient employees in Bermuda to avoid section 7874(b)), the U.S. employees, including Bob and the company top brass, likely receive a disproportionately high amount of the compensation. As a result, despite having most of its employees by headcount in Bermuda, BB could still fail to meet the 25% threshold with regard to employee compensation, and thus satisfy the test.

Whether there are substantial business activities in Bermuda likely depends on the location of the BB assets. The most significant assets are the cruise ships. The problem lists their adjusted tax basis as $170 million for Baby Buoy, $260 million for Sail Me Maybe, $175 million for Lady Gangway, and $95 million for Pink Float. Section 1.7874-3T(d)(5) allows assets to be valued "on a gross basis (that is, not reduced for liabilities) using either the adjusted tax basis or the fair market value." For purposes of the 25% threshold, an asset is treated as located in the relevant country if the asset was physically present in that country at the close of the acquisition date and for more time than in any other country during the one-year period ending on the acquisition date. The term acquisition date means the date on which the acquisition described in section 7874(a)(2)(B)(i) is completed (*i.e.*, when substantially all of the assets of the target corporation are acquired). Assets that are subsequently moved out of Bermuda in connection with a plan that existed at the time of the inversion transaction are backed out of the numerator, but not the denominator, of the calculation.

It is likely that Lady Gangway will be considered the only ship located in Bermuda, and so based on adjusted tax basis, exactly 25% of the cruise ships would be treated as located in Bermuda. Lady Gangway operates entirely in and around Bermuda, and was therefore physically present in the country on the acquisition date and for the entire year leading up to it. Baby Buoy, on the other hand, cruises solely in the waters around Miami and the Florida Keys; it should be included in the denominator, but not the numerator for purposes of the test. Although Pink Float will have been in Bermuda for more time in the year preceding the acquisition than in any other country, assuming that the emergence transaction occurs by the end of 2012, it will not have been physically present at the close of the acquisition date and thus not located in Bermuda for purposes of the regulations. The fact that Bob plans to move Pink Float back to Bermuda in 2013 is likely not relevant, as there is no counterpart to the rule of section 1.7874-3T(c)(3), discussed below, for assets that are intended to be moved into the relevant jurisdiction at the time of the transaction. Accordingly, Pink Float should not be considered a Bermuda asset for purposes of meeting the test. Finally, Sail Me Maybe likely should not viewed as located in Bermuda, although it operates in and around Bermuda, because of plans to move it to Jamaica sometime next year. Under section 1.7874-3T(c)(3), an asset that is present in the relevant country at the time of the acquisition and is subsequently transferred to another country in connection with a plan that existed at the time of the acquisition, is not included as an asset located in the relevant jurisdiction for purposes of meeting the 25% threshold. An argument could be made that the regulation requires more than the intent to move the asset, but that the asset is actually moved elsewhere pursuant to an existing plan. The problem indicates that Bob would move Sail Me Maybe next year because he is looking to expand into Jamaica, and so it at least suggests that there may be an existing plan. As noted above, without Sail Me Maybe, exactly 25% of the cruise ships would be treated as located in Bermuda; however, if the argument that there is not an existing plan to move the ship prevails, Bob would likely meet the threshold for

having substantial business activities in Bermuda.

Assuming exactly 25% of the cruise ships are treated as being located in Bermuda, the rented office and port facilities will shift the overall percentage slightly below 25% and cause the company to satisfy the test (and thus trigger the application of section 7874(b)). Under section 1.7874-3T(d)(5), a group asset includes rental property that is used in an active trade or business and is being rented as of the close of the acquisition. A rented asset is valued at eight times the net annual rent paid or accrued with respect to the property. The term net annual rent means the annual rent paid or accrued with respect to property, less any payments received or accrued from subleasing such property. Treas. Reg. § 1.7874-3T(d)(8). The balance sheet indicates that ES rents port facilities in Bermuda for $42,000 per month and in Miami for $58,500 per month, as well as office space in Orlando for $7,500 per month. The balance sheet also indicates that ES subleases the Bermuda port and facilities for $27,000 per month. Thus, there are rental properties assets attributable to ES worth $7,728,000, with $1,440,000 located in Bermuda. Because only 18.6% of the rental properties are located in Bermuda, the overall percentage (including the 25% of the cruise ships located in Bermuda) would be less than 25%. Accordingly, BB would lack substantial business activities in Bermuda.

After the transaction, BB will have $100 million cash-on-hand. Thus, there is a question regarding how and under what circumstances the cash should be considered in determining whether the test has been met. The 2012 regulations define the relevant assets for the calculation as "tangible personal property or real property used or held for use in the active conduct of a trade or business." Treas. Reg. § 1.7874-3T(d)(5). The preamble to the 2006 regulations explains that the Service and Treasury believe that "the statutory phrase 'business activities' ordinarily does not include passive investment activities and related income and assets." T.D. 9265, 71 Fed. Reg. 32437. Although the 2006 regulations have been revoked, this view offers insight into how the government may continue to view investment assets and cash equivalents for purposes of determining substantial business activities.

We have no specific information regarding how the cash will be used, but it could be argued that it is likely to be used for working capital and therefore should be included as an asset held for a trade or business rather than a passive investment. Nonetheless, the better view would be to exclude the excess cash altogether for purposes of the test because (1) the problem gives no information about where the cash is located and (2) similar in nature to a passive investment asset, cash is fungible and portable, thus making its location not a meaningful indication of whether a corporation has or lacks substantial business activities in a certain jurisdiction. Accordingly, it is likely that the cash should be altogether excluded from the threshold calculation.

Note that the regulations also permit assets to be valued based on fair market value, if done so consistently. The balance sheet accompanying the problem does not provide fair market value, so this test cannot be applied. However, the best answer would note the lack of fair market values, and indicate that the result of the test could change if those numbers were provided. Indeed, the basis of the total unencumbered assets of ES equals approximately $1.1 billion, whereas BB paid $1.2 billion for those assets. Thus, the fair market value of the ES assets is likely greater than the assets' basis. Given that the newest ships include the Bermuda-based Lady Gangway, which would be subject to accelerated depreciation (*i.e.*, the basis would be reduced faster than the actual value), there is a strong possibly that the adjusted basis test would be undervaluing that asset and thus undervaluing the assets located in Bermuda.

J.D. Problem

The 2012 J.D. division problem involved several transactions in stock covered by section 83 and also involves the foreclosure of a home. The stock was acquired by Ray from WDU. Ray disposed of some of the stock to his brother Willy and eventually disposed of the remaining stock. In addition to debt discharge and use of the section 121 exclusion, the J.D. problem required teams to determine the basis of Ray's home and discuss the tax consequences of his renting the property to a third party and of damage caused by a ruptured water pipe. The discussion below covers only the issues related to the stock transferred by WDU (omitting issues related to the grant of an option in 2012).

Stock Transfer in 2002

Section 83 applies to property transferred to an employee in connection with services performed by that employee. It requires a taxpayer to include in his gross income the fair market value of the property transferred (less any amounts paid for such property) in the first year in which such property becomes transferable or is not subject to a substantial risk of forfeiture. I.R.C. § 83(a); *Tanner v. Commissioner*, 117 T.C. 237, 242 (2001).

For section 83 to apply to Ray's 2002 stock, there must have been (1) property that (2) was transferred to Ray (3) in connection with his performance of services. Property includes real and personal property. Treas. Reg. § 1.83-3(e). A transfer occurs for the purposes of section 83 when a person acquires a beneficial ownership interest in such property, ignoring any restrictions as to non-transferability and forfeiture. Treas. Reg. § 1.83-3(a)(1), (i). A person does

not have to have title to property but has to have rights in the property equivalent to normal incidents of ownership. *Kadillak v. Commissioner*, 127 T.C. 184, 196 (2006). Property is transferred in connection with the performance of services when an employer transfers property to an employee in recognition of the performance of, or the refraining from performance of, past, present, or future services. Treas. Reg. § 1.83-3(f).

Property must be substantially vested—either transferable or not subject to a substantial risk of forfeiture—in the employee for it to become taxable. *See* Treas. Reg. §§ 1.83-1(a)(1) & 1.83-3(b). A person's rights in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of the property are conditioned upon the future performance of substantial services by any individual. I.R.C. § 83(c)(1); Treas. Reg. § 1.83-3(c). A person's rights are transferable only if the rights of any transferee are not subject to a substantial risk of forfeiture. I.R.C. § 83(c)(2); Treas. Reg. § 1.83-3(d).

The stock Ray purchased from WDU is property for the purposes of section 83. *See Childs v. Commissioner*, 103 T.C. 634, 648–49 (1994); *see also* Treas. Reg. § 1.83-3(e). There was a transfer because Ray has the opportunity to own the property outright if he remains employed by WDU (*i.e.*, there's no condition requiring its return that is certain to occur—*see* Treas. Reg. § 1.83-3(a)(3)), and he incurs the risk that the value of the property at the time of the transfer will decline substantially. *See* Treas. Reg. § 1.83-3(a)(6). Although Ray must surrender the stock if he ceases working for WDU before January 1, 2007, section 1.83-3(a)(1) disregards any restrictions as to non-transferability and forfeiture.

The property was transferred in connection with the performance of services because it was transferred to Ray as part of his employment and he must perform future services to retain full enjoyment of the property. *See* Treas. Reg. § 1.83-3(f). None of the exceptions contained in section 83(e) apply. Therefore, section 83 governs the tax consequences arising from Ray's purchase and sale of the WDU stock.

Stock Sale to Willy in 2006

Ray sold 250 shares of WDU stock to Willy on January 1, 2006, for $30 per share when the stock was worth $45 per share. Regulation section 1.83-1(c) provides that if substantially nonvested property transferred in connection with the performance of services is disposed of in a transaction which is not at arm's length and the property remains substantially nonvested, the person who performed services realizes compensation. The amount of compensation is equal to the sum of any money and the fair market value of any substantially nonvested property received in such disposition. *Id.* However, the amount of compensation cannot exceed the fair market value of the property disposed of at the time of the disposition (without regard to any lapse restriction), reduced by the amount paid for such property. Section 83 continues to apply to the property until the restrictions lapse; however, the amount previously includible in gross income is treated as an amount paid for the property.

In 2006, Ray's stock was substantially nonvested. *See* Treas. Reg. § 1.83-3(b). It was subject to a substantial risk of forfeiture because Ray's full enjoyment of the stock was conditioned upon his performance of substantial future services and WDU was not required to pay the fair market value upon the return of the stock. *See* Treas. Reg. §§ 1.83-3(c) & 1.83-3(c)(4), Example (1). His stock was also nontransferable because the forfeiture restriction was stamped on the stock certificate and applied to all subsequent transferees. *See* Treas. Reg. § 1.83-3(d). The sale of the stock to Willy is considered a non-arm's length disposition because Willy is Ray's brother.

Ray's compensation is measured first by the amount realized from Willy ($30 per share), but limited to the difference between the stock's fair market value in 2006 ($45 per share) and the amount Ray paid for the stock ($20 per share). That difference is $25 per share, so Ray's compensation income in 2006, subject to payroll taxes, is $6,250 ($25 per share x 250 shares).

Vesting in 2007

Because section 83 continued to apply to the stock until the restrictions lapsed, Ray recognized further compensation income in 2007 (the year the restrictions lapsed) with respect to the shares sold to Willy. His compensation income equaled the difference between the stock's fair market value in 2007 ($50 per share) and the amount Ray paid for the property ($20 per share in 2002 plus $25 per share includible in income in 2006, or $45 per share). That difference is $5 per share ($50 per share minus $45 per share), so Ray recognized an additional $1,250 ($5 per share x 250 shares) in compensation income, which is subject to payroll taxes, when the restrictions lapsed in 2007.

Ray also had gross income of the difference between the January 1, 2007, fair market value ($50 per share) and the amount he paid for the retained stock ($20 per share). He had compensation income, subject to payroll taxes, in 2007 of $22,500 (750 shares of WDU stock x $50 fair market value less $20 price paid by Ray per share) on the 750 remaining shares of WDU stock. Ray's basis in the retained WDU stock during the period before the restrictions lapsed was equal to the amount he paid for the stock, or $20 per share. *See* Treas. Reg. § 1.83-4(b)(1). Once the restrictions lapsed in 2007, Ray's basis in the WDU stock increased to $50 per share, which reflected the amount Ray paid for the stock ($20) and the amount Ray included in his gross income under section 83(a) as a result of the restrictions lapsing ($30 per share). *See* Treas. Reg. § 1.61-2(d)(2) & (6)(i).

Potential Stock Sale in 2012

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis. The amount realized is the sum of any money received plus the fair market value of the property (other than money) received. I.R.C. § 1001(b). Ray would therefore have to recognize $7,500 (750 shares x $60 amount realized less $50 basis) in 2012 upon the sale of his 750 remaining shares of stock. The character of that income would be long-term capital gain. *See* I.R.C. §§ 1221(a), 1222(3).

In 2012, the maximum capital gains rate was 15%. Because it was not clear when the problem was distributed what the maximum rate would be after 2012, Ray might have considered taking advantage of the 15% rate then in effect for 2012 and selling the stock that year. On the other hand, the stock consistently increased in value since 2002. Ray might have considered holding onto the stock to maximize his gain from the stock sale or waiting to sell it in a year when he has capital losses to offset his gains. ■

SAVE THE DATE

13th Annual Law Student Tax Challenge (2013-2014)

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 a client explaining the result. Based on the written work product, six teams from the J.D. Division and four teams from the LL.M. Division receive a free trip (including airfare and accommodations for two nights) to the Section of Taxation 2014 Midyear Meeting, January 23-25 in Phoenix, AZ, where each team will defend its submission before a panel of judges consisting of the country's top tax practitioners and government officials, including Tax Court judges.

The competition is a great way for law students to showcase their knowledge in a real-world setting and 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 Section of Taxation website at **www.americanbar.org/tax** or contact the Section at **taxmem@americanbar.org**.

IMPORTANT DATES

- **Problem Release Date:** September 6, 2013 released by or before 5pm ET
- **Submission Deadline:** Friday, November 8, 2013 by or before 5pm ET
- **Notification of Semifinalists and Finalists:** December 20, 2013
- **Semifinal and Final Oral Defense Rounds:** Friday, January 24, 2014, in Phoenix, AZ

Christine Brunswick — 2013 Distinguished Service Award Recipient

Contributors: Ellen Aprill; N. Jerold Cohen; Charles Egerton; Lawrence B. Gibbs; Gersham Goldstein; Phillip Mann; Nina Olson; Ron Pearlman; Rudolph Ramelli; Paul Sax; Richard A. Shaw; and Stefan Tucker.

It is with great pride in her accomplishments and equal sadness at her passing that the Section of Taxation of the American Bar Association honors Christine Brunswick, the Section's cherished Executive Director, with its 2013 Distinguished Service Award. Although the award is presented posthumously, Christine was informed of her selection shortly before her untimely death earlier this year.

The Section fairly lays claim to being the finest volunteer organization of its kind anywhere, serving with tenacity both the professional goals of its members and the betterment of our nation's taxing system. Whether by supplying dozens of technical comments annually to the Treasury and Internal Revenue Service, conducting educational meetings attended by thousands, leading the cause of tax reform through simplification, or advocating IRS funding adequate to its mission, the Section's role in the tax system has become unique and important.

For nearly 30 years Christine Brunswick was the principal guiding force in shaping the Section's fortunes, managing both Section leadership and Section staff with grace, aplomb, efficiency, and above all, great and good humor. The tone she set became pervasive, nurturing a spirit of cooperation amid goodwill, the sense of belonging to something worthwhile, and the willingness to work hard to achieve success. Under Christine's stewardship, Council dinners became delightful occasions facilitating a dialogue between Section leaders and Government guests intended to shape the improvement of tax policy and administration. Section meetings became "must-attend" events for continuing education, government personnel interaction, and the nurturing of friendships. Section submissions were managed seamlessly, and the Section's voice was heard in the right places, on the right subjects, and at the right time.

Christine's manner was one of complete competence whatever the stress level, enveloped by a gloss of endless patience. Former Chair Jerry Cohen observes that she could answer a question for the tenth time, quietly and accurately, with the same grace as she had the first time. She was so utterly in charge that incoming Section Chairs viewed her as a Co-Chair. Her command of the Section's history was full and her ability to summon relevant detail impressive. Chris mentored generations of Tax Section staff and watched them bloom. She likewise counseled generations of Council Directors and Section Officers in the ways of the ABA, and the need to subordinate oneself to the best interests of the Section. Her years of service produced many friendships, all of them treasured and enduring.

Christine was a superior delegator, recruiting and training able personnel then entrusting them to perform to her expectations. Her dear friend, National Taxpayer Advocate Nina Olson, attributes this to her formative years when, according to her brothers, she figured out how to get them to do the household chores so she could read and study, demonstrating executive leadership in its early form.

One of Christine's major responsibilities was to manage the Section's often testy relationship with the ABA headquarters staff in Chicago, a role for which she was well-suited and which she acquitted admirably. She fought vigorously for the Section's independence, regularly securing far better hotel rates for our members, more attractive venues, better treatment for her personnel, and above all the Section's ability to make government submissions without bureaucratic interference. This was not done without stress, which she met in characteristic fashion, once joining several members of the Section in a secret Betsy Ross committee which produced a large Tax Section flag, replete with Section blue trim, employing a "Don't Tread on Me" motif and other features not wholly deferential to ABA headquarters. That Section flag never flew over the White House, or for that matter anywhere else. But in our mind's eye, it flies today as a tribute to Christine's independence, having dutifully flown at half staff on the day in February that we lost her.

The Section is proud of its strong commitment to the values of diversity, and Christine was an early and vigorous force, particularly in the advancement of

women in the profession, not an easy thing in a tax bar that not so long ago consisted largely of graying white men. Christine was a change agent; her passion infected the process, for at every turn it was Christine who would ask the pointed question, focus on the healthy direction. She managed a deft touch that felt to the men's club of the time a perfect combination of love and disdain.

Stylistically, Christine would chew on a problem, seemingly interminably, but once she decided would move with dispatch. Her network was extensive and, in her capacity as chief problem-solver for the Section, she never hesitated to call on members of that network to move a good idea forward. She was a devoted champion of many new ideas that became embedded to the credit of the Section: low-income taxpayer clinic fellowships, the VITA program, the Janet R. Spragens Pro Bono Award, international conferences, and the Nolan Fellows program to inspire the best of young tax lawyers, all found Christine's vigorous support.

Christine was not at all bashful about regaling us with tales of her greatest role in life, that of Mom. The Section was enough of her world that for decades we heard about Daniel growing up, where Daniel is going to school, where he is going to practice law, and whether that young man will find a wife. There was great joy in witnessing Christine's pride in Daniel, and it bonded us to her in ways that made the Section akin to family for so many.

Notable among Christine's accomplishments was her role as long term breast cancer survivor, advocate, and counselor. She defeated her first recurrence and succumbed only to her second. In the intervening decades she was indefatigable. A leader since inception of the National Breast Cancer Coalition, in her public role she was a media spokesperson, international conference speaker, and organization executive. In her private persona, she would routinely drop everything to spend hours on the phone, counseling the latest "friend of a friend" victim through the turmoil of diagnosis, treatment options, and fear management, all with an empathy borne of thoroughgoing understanding.

For sure, Chris was great fun, an eager but talent-challenged karaoke performer, a lover of fine food and wines. A vivid and not atypical memory has Christine out on a warm summer night, after a perfectly delightful dinner in Georgetown, walking the entire route back to the Grand Hyatt, weaving along as the personal guide to a Section Chair and Vice Chair whose judgmental processes had concluded that to be a good idea. Maybe that is how the scene best ends for Christine, at the end of the trail, waiflike, carrying her purse in one hand, shoes in the other, strolling leisurely into the evening, still doing her job but having a grand old time. ■

GOVERNMENT SUBMISSIONS BOXSCORE

Since April 10, 2013, the Section has coordinated the following government submissions, which can be viewed and downloaded from the Section's website at http://www.americanbar.org/groups/taxation/policy.html.

SUBMISSIONS AND COMMENTS ON GOVERNMENT REGULATIONS, ADMINISTRATIVE RULINGS, BLANKET AUTHORITY and ABA POLICY

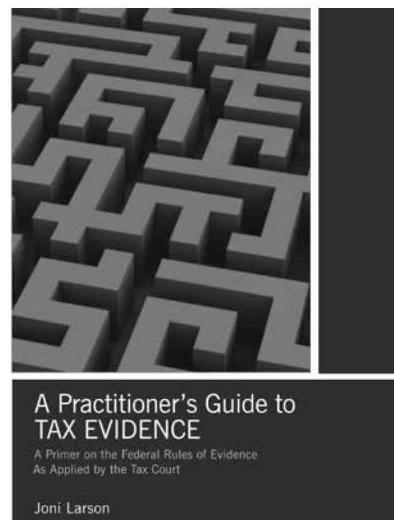
TO	DATE	CODE SECTION	TITLE	COMMITTEE	CONTACT
Internal Revenue Service	7/23/2013	n/a	Comments Concerning Accountable Care Organizations	Section of Taxation and Health Law Section	Frederick J. Gerhart
Internal Revenue Service	7/9/2013	6708	Comments Concerning Proposed Treasury Regulations Under Section 6708	Civil and Criminal Tax Penalties	Larry Campagna, Megan L. Brackney, John M. Colvin, Miriam Fisher, Scott D. Michel
Department of the Treasury, Internal Revenue Service	7/8/2013	Various	Recommendations for 2013-2014 Guidance Priority List	Multiple	Various
Internal Revenue Service	6/24/2013	6050	Comments on Guidance Concerning Information Reporting for Discharges of Indebtedness	Bankruptcy and Workouts	Lee G. Zimet
Internal Revenue Service	6/4/2013	4980H	Comments on Proposed Regulations Issued Under Section 4980H	Employee Benefits	Linda R. Mendel, Mark A. Bodron
Internal Revenue Service	4/30/2013	n/a	Comments on Proposed Series LLCs Regulations	State and Local Taxes, Partnerships and LLCs	James E. Long, Jr.

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.

BOOK REVIEW

A Practitioner's Guide to Tax Evidence

by Joni Larson



By Keith Fogg*

Professor Joni Larson has done a great service for all Tax Court practitioners. Her new book, *A Practitioner's Guide to Tax Evidence*, provides a detailed passage through the Federal Rules of Evidence (FRE) as applied by the Tax Court. This compilation results in an easy-to-read collection of cases to support or guide a practitioner facing an evidentiary problem in a Tax Court case.

My Tax Court practice spans over the past 35 years, but the actual trial of cases by me has run in fits and starts with occasional lengthy periods of inactivity. Like many Tax Court practitioners, most of my cases settle, making my knowledge of the FRE one that lacks the quality of a more frequent litigator. As an initial response to the book, I found reading it quite helpful in jogging my memory on issues that arise infrequently or that I have never faced. For this reason alone, the book deserves attention from those who practice in Tax Court regularly but engage in litigation infrequently.

The biggest benefit of this book comes from the work Professor Larson has done to pull together large numbers of cases on the various FREs. Because Tax Court practice has issues that receive regular attention, this book offers a chance to find those cases easily and to compare the Court's reaction to the application of the FRE in similar but distinct circumstances. She provides a brief description of the relevant evidentiary issue in each case, allowing the reader to quickly compare numerous cases decided under a particular FRE provision.

After each FRE section that receives regular attention from the Tax Court, Professor Larson gives a brief summary of the requirements of that section. These bracketed summaries offer a helpful entry to the case discussion. The discussion following the summaries contains a well-documented, 1,258 footnote, insight into the Tax Court's take on the FRE. Several of the provisions deserve specific mention.

The change to the Internal Revenue Code in 1998 with respect to burden of proof created much uncertainty regarding the responsibility of each party to put forward evidence and carry the ultimate burden. The burden of proof section allows the reader to see the development of this issue through the cases. Between the case law and the accompanying text, the burden of proof section may contain the most thorough discussion of this issue I have seen.

The discussion of relevance sets out an extensive collection of cases on this topic. The benefit to having a detailed discussion of this issue, which contains only Tax Court decisions, comes from the frequency with which certain relevance issues arise in tax matters. The discussion of the use of information on returns subsequent to the year at issue highlights the benefit of a tax-focused discussion of this provision of the FRE. Having so many cases on this issue analyzed allows anyone researching this issue to quickly reach conclusions concerning the use of tax information outside the year at issue.

Some of the FRE discussions also tie into the Tax Court rules. Section 615 on excluding witnesses offers a good example of the link between the two provisions. Having the evidentiary rules linked with the Court's rules aids in understanding and applying both provisions.

The method of using experts in trial is one of the unique features of the Tax Court. The book's section on FRE 702 contains an excellent discussion of the factors the Tax Court considers in the use of expert witnesses. The extensive case compilation on this subject will aid anyone trying to prepare for the use of an expert in Tax Court. Because the proper use of an expert requires careful planning, the book provides significant value on this subject. The discussion of the *Rovakat* case at the end of this section serves as an excellent reminder of the discretion available to the Court on this issue, reminding the reader of the role of the expert as a guide and aid to the Court.

In addition to the many FRE sections containing exhaustive and detailed discussion of the Tax Court decisions, the book also provides value by quickly confirming those sections on which the Court has not ruled. In the pursuit of an answer when researching, finding a negative result proves as difficult as finding the right cases. Professor Larson lists all FRE sections and notes those sections which the Tax Court has not yet addressed.

Having a book that focuses on the Tax Court's rulings regarding FRE issues greatly aids the bar of that Court. Professor Larson's condensed and well-organized sections allow one to easily spot a particular issue or the evidentiary rule at hand and to find the supporting cases. The case discussions have sufficient detail to allow the reader to know whether to go and read the full case. The brief summary of requirements of the major rules assists the practitioner in charting the proof necessary to succeed. Overall, those practicing in the Tax Court owe a debt of gratitude to Professor Larson for her work to assist in preparing for trial. ■

For more information and to order a copy of *A Practitioner's Guide to Tax Evidence: A Primer on the Federal Rules of Evidence As Applied by the Tax Court*, by Joni Larson, ISBN 978-1-61438-721-3, $79.95 Tax Section Members, visit www.shopABA.org.

* Professor of Law and Director of Federal Tax Clinic, Villanova Law School, Villanova, PA. This review was originally published as the Foreword in *A Practitioner's Guide to Tax Evidence: A Primer on the Federal Rules of Evidence As Applied by the Tax Court.*

TAX Bites
Tax Bites Serenade Continues

By Robert S. Steinberg*

No Reasonable Cause

(To tune of “Sealed with a Kiss,” by Peter Udell and Gary Geld, as recorded by Brian Hyland in 1962)

Oh I needed for the deal an opinion
From a tax lawyer Santa Clause
Lofty phrases of good law in a wonder of letters
Bought for reasonable cause.

For in every deal there’s audit potential
And an agent who’s seeking applause
An adjustment may propose, if it grows too substantial
I’ll need reasonable cause.

An opinion that it “should” work
A theory, may it please the court
And no one’s caring if it could work
For shelter’s the game and the sport.

Any common sense would notice a conflict
When need pours the fees on like sauce
From now on you can tear up those swell written letters
There’s no reasonable cause.
No reasonable cause.
No reasonable cause.

Put a Buck in Your Pocket, and Pay One to Uncle Sam

(To the tune of “One for My Baby (and One More For the Road),” by Harold Arlen and Johnny Mercer)

Set ‘em up Steve
It’s April the fifteenth, tax filing eve.
I’ve got the form here
I need a little booze to loosen the fear
For this line where it shows
How much one owes
Put me on edge, “damn.”
You put a buck in your pocket,
And give one to Uncle Sam.

Now don’t get me wrong
All my patriotic feelings run strong.
That fervor feels nice
But wish that would feel it
For half of the price.
It’s like you’d offer a meal
But not if you feel
They would hog the whole ham.
You put a buck in your pocket,
And give one to Uncle Sam.

Where’s it all going?
The government keeps growing,
It just grows and it grows.
We keep on sowing
Without ever knowing
Where it all goes.

Well that does it Steve,
The post office is closing
So I’ve got to leave.
Thanks for the cheer
I probably will see you
This time next year.
That’s assuming that I’m
Not serving some time.
If I get in a tax jam
Put a buck in my pocket,
And give none to Uncle Sam.

Put a buck in your pocket,
And good luck with Uncle Sam.

Who’ll Represent Me Tomorrow?

(To tune of “Will You Still Love Me Tomorrow?” by Carole King and Gerry Goffin, recorded by The Shirelles)

My lawyer’s been indicted
To serve some time invited.
That hot shot liar I paid hefty fees
Who’ll represent me tomorrow?
He sold me on tax scheming
The agent laughed, “You’re dreaming.”
They’ve locked him up and thrown away the keys
Who’ll represent me tomorrow?

Thought I was smart and plucky
Finagling taxes, paying less.
Now I feel dumb, not lucky
Fear each knock at my door is the IRS.

Feel like a fool forsaken
My bank accounts they’ve taken.
So please one honest lawyer do you know,
Who’ll represent me tomorrow?

Go Fly Away

(To tune of “Come Fly with Me” by Jimmy Van Heusen and Sammy Cahn from the Frank Sinatra Capitol Records album of the same name)

Go jet away, go get away, be fast
Skip out on bond across the pond
Then fondly muse the past
Get going fly, before the die is cast.

Build up a stash, do wire cash my pal
Or take a boat, across the moat
To some remote locale
Go have a bash and don’t crash like Big Al.

Make an expedition
Where no extradition lies.
It’s paradise
When there’s no tax, it’s so relaxing.

Whether you plead innocence or guilt,
That fellow Klein, a friend of mine,
Was sewed up like a quilt.
Conspiracy and you’ve no alibi
Be sly today, go fly away, bye-bye. ■

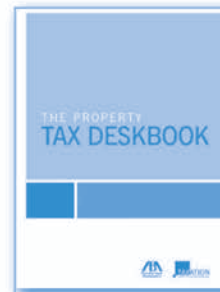
* Law Offices of Robert S. Steinberg, Palmetto, FL.

ABA SECTION OF TAXATION

New Release—The 26th Edition of the Sales & Use Tax Deskbook

Join the Tax Section in celebrating the release of the 26th (2013) Edition of the *Sales & Use Tax Deskbook*. Designed for in-house tax professionals, attorneys, and accountants, this multistate resource compiles information about sales and use taxes from every state that imposes them. Not only does the *Deskbook* set out the key principles and positions in each state (with citations to pertinent statutes, regulations, and case law), it also contains important interpretive information—gleaned from rulings, bulletins, and other local lore—that is often impossible for out-of-state practitioners to find. The *Sales & Use Tax Deskbook* draws from the long-term contributions and expertise of almost 100 members of the Tax Section's State and Local Taxes Committee.

Coming soon—the 18th (2013) Edition of the *Property Tax Deskbook*. Modeled after the *Sales & Use Tax Deskbook*, this comprehensive guide provides taxpayers and tax practitioners with an essential, reliable, annually updated compendium of information about the property tax in all 50 states and the District of Columbia.



Standing Order lists are available! Visit the Deskbook product pages on the ABA webstore at www.ShopABA.org to sign up. You'll receive a discount of 25% off the list price and receive your copy of the book as soon as it is available—no more having to remember to place your order each year.

Check out these other essentials from the Tax Section:

- Effectively Representing Your Client Before the IRS, 5th Edition
- A Practitioner's Guide to Innocent Spouse Relief
- Careers in Tax Law: Perspectives on the Tax Profession and What It Holds for You
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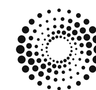
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