The Top 10 Tax Stories of 2005

By Paul L. Caron

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Here are the ***Top 10 Tax Stories of 2005***, generated from a post on the TaxProf Discussion Group the last week of December 2005:

1. ***The Report of the President's Advisory Panel on Federal Tax Reform***, by **Steve Johnson**, E.L. Wiegand Professor of Law, William S. Boyd School of Law, University of Nevada at Las Vegas:

> This report will not have immediate impact, in the sense of legislative adoption. This is unlikely to ''go anywhere'' politically. Nonetheless, the report contains analyses and makes proposals that should contribute to the ongoing debate as to fundamental tax reform. It was worth the effort, and the Panel members deserve our thanks.

2. ***Commissioner v. Banks***, 543 U.S. 426 (Jan. 24, 2005), by **Steve Johnson**:

> Resolving (at least for now) a lower-court split, the Court held that, for cases not controlled by the section 104 exclusion or the relief for civil rights plaintiffs in the American JOBS Creation Act of 2004, the portions of tort recoveries used to pay attorneys fees are generally includible in the plaintiffs' income. The consequences are that the regular income tax deduction for attorneys fees is ''below the line'' and that the fees are not deductible for AMT purposes. Opinions on this result vary widely. My own views are that:
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> 1. the Supreme Court reached the correct result under the law, but
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> 2. its reasoning applied the assignment-of-income doctrine unfortunately expansively, and
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> 3. the policy results (perpetuating harsh and unfair tax treatment of plaintiffs) are bad.
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> Those (like me) who think that the courts should apply the law as it exists, and that correcting resultant unfairness is the job of the legislature, should like the result, if not necessarily the rationale, of the Supreme Court's decision. I hope very much that Congress will extend the AJCA relief to non-civil rights plaintiffs.

3. ***Tax Legislation: AMT & Estate Tax: No; Katrina: Yes***, by **James Edward Maule**, Professor of Law, Villanova University School of Law:

> Somehow the Congress managed to run out of time to fix the alternative minimum tax so that it would not grab an additional 15 million taxpayers, mostly from the middle class and not within the original intent of the alternative minimum tax. The almost-certain permanent repeal of the estate tax was washed to the side by the political and economic consequences of Hurricane Katrina. And, speaking of hurricanes, in late December Congress DID manage to enact legislation specifically tailored to assist victims of Hurricanes Katrina and Rita. The Gulf Opportunity Zone Act of 2005 came months after the IRS implemented tax breaks for hurricane victims within days of the disasters.
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> These developments unfortunately highlight the challenges facing those trying to reform the income tax. Congress appears to lack an overall vision of how the tax law should be structured. Although it managed, four months after the fact, to enact relief legislation for a highly visible problem, Congress failed to deal with several looming tax crises even though the inevitable arrival had been heralded for several years. The relationship between Congress and tax law is so significant that whatever Congress does or does not do with respect to taxation is guaranteed to be among each year's top 10 tax stories.

4. ***Scrutiny of Charities***, by **Ellen P. Aprill**, Associate Dean of Academic Affairs, Professor of Law, and John E. Anderson Chair in Tax Law, Loyola Law School-Los Angeles:

> We had the Senate Finance Committee White paper last year and this year April hearings by Ways and Means on an Overview of the Tax-Exempt Sector and by the Senate Finance Committee on Proposals for Reform; June Senate Finance Committee hearings on Land Conservation, Report on Investigations and Proposals for Reform, the Report of the Panel on the Nonprofit Sector (convened by Independent Sector) on Strengthening Transparency, Governance and Accountability of Charitable Organizations, the IRS initiatives on executive compensation and political intervention (which produced the All Saints flap), but not the broad reform legislation once expected, but only rather modest proposals in the November 18th Senate Tax Relief Act.

5. ***Ballard v. Commissioner***, 125 S.Ct. 1270 (Mar. 7, 2005), by **Steve Johnson**:

> The Court said that the Tax Court doesn't understand its own Rules, or at least one of its own Rules (Rule 183). The considerable deference usually accorded to courts' interpretation of their own rules was shrunk to the far narrower "the Tax Court is not without leeway in interpreting its own Rules."
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> Presumably, the majority of the Justices felt that the Tax Court practice was unwise and perhaps unconstitutional, but they chose to resolve the case on a narrower ground by declaring that the Tax Court's practice in one category of cases was inconsistent with the Tax Court's Rule. If the idea was to let the Tax Court down easily, that surely has not been the result. The Supreme Court's decision led to flurries of bad publicity, circuit court reconsideration, Tax Court remands, Tax Court disclosures, and a Tax Court Rule change. The dust has not settled yet.
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> The most significant result of this long and painful story is damage to how the Tax Court is perceived. For generations, there have been some who have doubted (wrongly) the Tax Court's fairness. This saga has thrown fuel on this fire that will burn for a long time.

6. ***Streamlined Sales Tax — Certified Software Solutions — VAT Applications Project***, by **Richard T. Ainsworth**, Adjunct Professor of Law, Boston University School of Law:

> The Streamlined Sales and Use Tax Agreement (SSUTA) came into effect on October 1, 2005. It has an initial Governing Board of 18 states: Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, Utah, West Virginia, and Wyoming.
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> The Streamlined Sales Tax Project (SSTP) was organized in March 2000, largely in response to the states' perception that they were losing sales tax revenue from increasing online sales. Sellers without a physical presence in a state cannot be compelled to collect tax on sales destined for that state, according to the U.S. Supreme Court's decision in Quill Corp. v. North Dakota, 504 U.S. 298 (1992). The stated goal of the SSTP is to simplify and modernize sales and use tax administration in member states. When fully operational it is expected to reduce the burden of tax compliance on all sellers.
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> On October 1, a centralized online registration system, and an amnesty for qualifying sellers that volunteer to begin collecting state sales taxes came into effect. The certification of service providers had also been expected at this time, but as of this writing (December 30, 2005) no automated system has been certified for use under the agreement, although four compliance solutions are under review and formal certification is expected early in 2006 of several systems. The SST system will remain a voluntary one as far as remote sellers are concerned unless federal legislation is enacted giving the states mandatory collection authority.
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> Once the Agreement is fully operational, sellers will be able to use a centralized online registration system. Registration constitutes an agreement by sellers to collect and remit tax for sales into all full member states. Member states must provide an amnesty for uncollected or unpaid sales and use tax (together with penalty or interest) to a seller that registers under the Agreement, provided the seller was not registered in that state in the 12-month period preceding the state's participation in the Agreement. Sellers must register within 12 months of the state's participation to benefit, and the amnesty does not apply to matters for which the seller has received notice of the commencement of an audit.
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> The OECD is closely watching the SSUTA's operation as are foreign jurisdictions that impose transaction taxes under a multi-stage or VAT model. Certified systems offer opportunities for simplifying administration, increasing revenue streams and enhancing compliance under Sarbanes-Oxley and similar corporate governance regimes globally. In addition, it is expected that when Austria assumes the presidency of the European Union for the first six months of 2006 that certified solutions and adaptations of American retail sales tax mechanisms will be explored as a way of reducing VAT fraud in the EU. VAT fraud losses in the EU are estimated to exceed $70 billion a year, far greater than the estimated sales and use tax loss that the streamlined effort is addressing. Karl-Heinz Grasser, the Austrian finance minister, indicated recently that Austria has achieved some success in reducing "carousel fraud" through adjustments to the VAT in certain industries in a manner that mimicked the operation of the American retail sales tax. An automated solution that employed certified software would extend the effectiveness of the Austrian approach.

7. ***Telecommuter Tax***, by **Jim Maule**:

> Much can happen in a year. Consider the adventures of Thomas Huckaby, a Tennessee resident working at home in Tennessee for an employer with an office in New York. The New York Department of Revenue decided that he was subject to New York income tax despite his attenuated connection with the state. In January, his case was argued in front of the New York Court of Appeals. In March, that court affirmed the lower court decision that had upheld the Department of Revenue. In May, legislation was introduced to prohibit this sort of nonresident income taxation. In November, the United States Supreme Court refused to hear Mr. Huckaby's appeal.
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> The number of people in Mr. Huckaby's situation is growing and will continue to grow. Interstate telecommuting is destined to increase because the technology continues to improve, energy cost increases make telecommuting an even more sensible

idea, and workers are finding satisfaction in realigning priorities so that more time is available for family and less is invested on roads, trains, and airplanes. Legislatures, both state and federal, need to deal with the tax consequences of this eventual sea-change in the employment environment, particularly because state tax administrators and courts made the least of their opportunities in 2005 to deal with the issues appropriately. Whether 2005 goes down as the year in which taxpayers concluded enough was enough and triggered what will become valuable state income tax reform or just another year during which tax law sunk deeper into confusion and inexplicability.

8. ***Cuno v. DaimlerChrsysler***, cert. granted, 126 S.Ct. 36 (Sept. 27, 2005), 386 F.3d 738 (6th Cir. 2004), by **Steve Johnson**:

We sometimes pay less attention to state/local taxes than they warrant. The Sixth Circuit's opinion is a major case as to the ability of states to engage in tax competition, to provide incentives to attract or retain businesses. The Supreme Court's dormant Commerce Clause analysis as applied to state tax provisions may, perhaps not unfairly, be described as incoherent. *Cuno* offers a chance for the Supreme Court to create workable doctrine. (On the other hand, many Supreme Court decisions in the area have made doctrine less, not more, coherent. So, equal measures of hope and fear are perhaps the feelings many of us have about a Supreme Court decision in *Cuno*.) There were two important developments as to *Cuno* in 2005.

First, on January 18, 2005, the Sixth Circuit refused to rehear the case en banc, allowing the amended and superseding October 2004 opinion to stand. Second, on September 27, 2005, the Supreme Court granted cert. in the case. 126 S. Ct. 36. *Cuno* may be an even bigger story when the Supreme Court issues its opinion in 2006 than it was in 2005. Nonetheless, I still think it deserves mention on the 2005 list.

First, we didn't have a ''Top 10'' story in 2004 when the panel decision came out. Second, the Sixth Circuit's refusal to rehear en banc is itself significant. Third, there has been a lot of commentary and debate about *Cuno* in 2005. The many briefs that were filed with the Supreme Court are themselves significant items in the debate. Fourth, the Supreme Court may not reach the Commerce Clause merits when it decides *Cuno* in 2006. There is at least a fair chance that the Court will resolve the case purely on standing grounds, making the decision more interesting to Administrative Law and Constitutional Law folks than to Tax folks. So, omitting *Cuno* from the 2005 Top 10 in expectation of covering it in 2006, is a strategy that might backfire.

9. ***Littriello v. United States***, 95 A.F.T.R.2d 2005-2581, 2005-1 U.S.T.C 50,385 (W.D.Ky., May 18, 2005), by **Jim Maule**:

In a case of first impression, a U.S. district court upheld the validity of the check-the-box regulations. Even though these regulations are very favorable to taxpayers, in *Littriello* the taxpayer challenged the regulations because success in doing so would permit separation of his wholly owned LLC and his individual status, such that he would not be liable for employment taxes that the LLC failed to pay over to the Treasury. Several months later the court held course in response to the taxpayer's motion for reconsideration.

The decision was, at the very least, a disappointment to those commentators who had questioned the authority of Treasury and the IRS to issue the regulations, and to the critics who considered the position taken in the regulations to be too generous to taxpayers. Other commentators argued that the regulations are valid. Although a district court opinion is just that, a conclusion far from the lofty heights of a Supreme Court decision, it nonetheless was a long time in coming and sets the stage for possible subsequent litigation. The case does not prevent the Treasury and IRS from changing the regulations, but it illustrates how difficult it is for a taxpayer to challenge a regulation successfully, and it might quiet down the years-long debate over the validity of these particular regulations.

10. ***The Growth of Tax Blogs***, by **Paul L. Caron**, Charles Hartsock Professor of Law and Director of Faculty Projects, University of Cincinnati College of Law:

In December 2004, *Tax Notes* heralded the growing importance of tax blogs in an article by Warren Rojas, *Tax Bloggers Use Internet to Widen Tax Policy Appeal*, *Tax Notes*, Dec. 13, 2004, p. 1498. Here was the opening:

> Looking to expand tax policy talk beyond the pages of law reviews or academic tomes, a group of tax enthusiasts is infiltrating the ''blogosphere'' — an Internet world dominated by armchair journalists with opinions on just about everything — to vet contemporary tax topics. Part diary, part discussion, Web logs — ''blogs'' — for short — have given ordinary Web surfers a chance to add their two cents to Internet discourse. . . .
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> Tax professors and practitioners from across the country are betting the buzz will help draw average citizens into tax policy discussions — a hope that saw the establishment of ***four tax blogs*** in 2004 alone.

In 2005, the number and popularity of tax blogs exploded, enriching the daily professional lives of tax academics, practitioners, government officials, and students.

There are now well over a dozen active tax professor, tax practitioner, and tax think tank blogs:

Tax Professor Blogs:

- ataxingmatter (Linda Beale — Illinois)
- Conglomerate (Vic Fleischer)
- Jack Bog's Blog (Jack Bogdanski — Lewis & Clark)
- Mauled Again (Jim Maule — Villanova)
- Start Making Sense (Dan Shaviro — NYU)
- Tax Prof Blog (Paul Caron — Cincinnati)
- Tick Marks (Dan Meyer — Austin Peay State)

Tax Practitioner Blogs:

- Death and Taxes — The Blog (Joel Schoenmeyer — Illinois lawyer)
- Don't Mess with Taxes (Kay Bell — Texas journalist)
- Everything Tax Law (Kreig Mitchell — Colorado lawyer)
- Frederick Focke Mischler (Frederick Focke Mischler — Ohio lawyer)
- Our Taxing Times (Trish McIntire — Kansas Enrolled Agent)
- Roth & Company Tax Updates (Joe Kristan — Iowa CPA)
- Tax & Business Law Commentary (Stuart J. Levine — Maryland lawyer)
- The Tax Guru (Kerry Kerstetter — Arkansas CPA)
- Tax Mama (Eva Rosenberg — Nevada CPA)
- Taxable Talk (Russ Fox — California Enrolled Agent)

Tax Think Tank Blogs:

- Talking Taxes (Citizens for Tax Justice)
- Tax Policy Blog (Tax Foundation)

The popularity of tax blogs is also reflected in the increased attention and recognition they received in 2005. For example, TaxProf Blog welcomed its one-millionth visitor and was designated a ''must-read blog'' by the Wall Street Journal, called ''unfailingly excellent'' and ''highly recommended'' by Dennis Kennedy, and dubbed ''the undisputed champion of tax blogging'' by *Tax Notes*. Mauled Again received the coveted ''Best Law Professor Blog'' award in the annual ''Best of Legal Blogging Awards.''

Honorable Mention. A variety of other important tax stories did not make our Top 10 list but are chronicled here in alphabetical order:

- ***The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, P.L. 109-8***, by **Steve Johnson**: Bankruptcy is a major option for taxpayers with substantial tax debts. The 2005 Act changed many rules governing treatment of tax debts in bankruptcy, including rules as to dischargeability of taxes, interest, and penalties; so called ''Chapter 20'' strategy of Chapter 7 bankruptcy followed by Chapter 13 bankruptcy; valuation and payment of secured claims; treatment of tax liens; confirmation of plans; and the automatic stay. Although some of the changes benefit taxpayer/debtors, the changes, on the whole, benefit the Government. In addition, more generally, the 2005 Act seeks to shift many debtors from Chapter 7 to Chapter 13. The expectation is that this will result in creditors (including the IRS) getting more. If bankruptcy becomes less attractive as a result of the 2005 Act, the result should be additional emphasis (and perhaps pressure) on non-bankruptcy collection relief measures, such as offers in compromise and installment agreements.
- ***CDP***, by **Steve Johnson**: Since the CDP regulations took effect in 1999, the IRS has had over 92,000 CDP hearings and 30,000 equivalent hearings. Almost 2500 new hearing requests are filed each month. This is putting great pressure on the system. There were several responses in 2005, among them: In Fall 2005, the IRS released proposed regulations to tighten the CDP hearing process, Notice of Proposed Rulemaking REG-150091-02 & 150088-02. The Tax Court imposed Sec. 6673 sanctions on many taxpayers bringing frivolous CDP claims, IR-2005-64. The Tax Court for the first time allowed the IRS to continue with collection despite the pendency of a (frivolous) CDP case, Burke v. Commissioner, 124 T.C. 189 (2005).
- ***Circular 230***, by **Steve Johnson**: The final Circular 230 revisions released in December 2004 proved to be somewhat less than final. The revisions became generally effective in June 2005. However, in response to protests from practitioners and professional groups, the IRS made major revisions in Spring 2005, IR-2005-59; T.D. 9201. Then, in June 2005, the IRS relaxed the rules for state-and-local-bond opinion writers. The game is not over.
- ***Corporate and International Tax Guidance***, by **Steve Johnson**: The American JOBS Creation Act of 2004 enacted many provisions of principal significance to corporations. In 2005, the IRS and Treasury issued guidance on those provisions and on other corporate and international topics as well. This included: (i) Section 199 guidance, IRS Notice 2005-14 & Notice of Proposed Rulemaking REG-105847-05; (ii) three rounds of guidance re sec. 965 foreign profit repatriation: Notices 2005-10, 2005-38, and 2005-64; (iii) final and proposed regulations on income allocation to CFC shareholders under sec. 951: T.D. 9222 (Aug. 25, 2005, corrected Nov. 9, 2005); (iv) consolidated loss proposed regulations under sec. 1503: Notice of Proposed Rulemaking REG-102144-04; and (v) final regulations on continuity-of-interest under sec. 368: T.D. 9225.
- ***Cunningham's Resignation***, by **Jim Maule**: In November, after pleading guilty to conspiring to commit bribery, honest services fraud, and tax evasion, Congressman Randall ''Duke'' Cunningham resigned his congressional seat. He had filed his 2004 tax return, a year for which he had $1.2 million of gross income, showing income of only $121,079. Prosecutors called the situation ''a crime of unprecedented magnitude and extraordinary audacity.'' Indeed, a look at the details is disturbing. It's no suprise that Congress doesn't treat the Internal Revenue Code with the care it deserves, but Cunningham's attitude goes beyond the elevation of political expediency over worthwhile tax policy. It smacks of a selfishness so severe that its spread throughout the citizenry would doom the revenue and the nation's economic viability, if not its existence. The tax law, to be effective, requires its enactors to be upstanding role models. Whether Cunningham is an aberration, or simply just one who happened to be caught, remains to be seen. But at least he was stopped before he became something like Chair of Ways and Means. The good news in this story is that sometimes the system indeed works.
- ***Enforcement***, by **Steve Johnson**: The IRS always does some taxpayer service and some enforcement, but the emphasis each receives shifts over time. The early portion of Commissioner Rossotti's tenure

stressed "customer" service; the Everson era involves a heavier dose of enforcement. 2005 saw a continuation of that trend. In Spring 2005, in IR-2005-38 and FS-2005-14, the IRS described the growing tax gap and identified tougher enforcement as a major part of the IRS's intended response to that growth. On November 3, 2005, Commissioner Everson, before TV cameras at IRS Headquarters, touted the IRS's dramatically higher audits rates and record enforcement collections. Until the pendulum swings again, there will be greater emphasis on high-income taxpayer enforcement.

- ***Hatch's Tax Troubles***, by **Jim Maule**: In September, Richard Hatch, who won the first Survivor competition, was indicted for tax fraud and fraudulently using charitable donations for personal expenses. Even though his tax return preparer included Hatch's Survivor winnings and other income on a tax return, Hatch did not file the return. The same happened with a second preparer. Hatch then filed a hypothetical return prepared to show the outcome of not including the income, despite the preparer's warning not to do so. Sometimes a top 10 story is a matter of deja vu. What is it that successfully entices celebrities, living in a fish bowl, to ignore their tax filing and tax paying obligations? The chances of being caught are much higher than those faced by ordinary taxpayers. Is it bad budgeting, a spending of income without setting aside amounts for taxes? Is it stupidity? Is it using Rep. Cunningham as a role model? Perhaps the news that someone who can prevail in Survivor cannot withstand the eagle eye and persistence of the tax collector will intimidate ordinary folks to comply. The tax audit gamble, so attractive to those willing to live close to the edge, remains just that, a risk and not a certainty.
- ***Partnership Guidance***, by **Steve Johnson**: Subchapter K is becoming more important year by year. Reflecting this, the IRS and Treasury issued a lot of partnership tax guidance in 2005. This included: T.D. 9193 (final regulations as to installment sales of contributed property and property distributions); Notice 2005-32 (interim guidance re mandatory partnership basis adjustments); Notice 2005-43 (proposed regulations as to partnership interests received for services); and T.D. 9207 (final regulations as to partnership duplicated loss transactions).
- ***Seippel v. Jenkins & Gilchrist***, by **Jim Maule**: In August, the U.S. District Court for the Southern District of New York refused to dismiss a taxpayer's fraud and recission claims against a prominent law firm that had played a role in causing the "Currency Options Bring Reward Alternatives" tax shelter to be recommended to the taxpayer. The law firm had provided opinion letters stating that the taxpayers were entitled to loss deductions, but did not disclose that the shelter was developed by attorneys working for the law firm. Other claims brought by the taxpayers, such as RICO, malpractice, breach of fiduciary duty, negligent misrepresentation, and breach of contract, were dismissed. Most of them because the statute of limitations had expired. Until this decision, taxpayers had been faring poorly in other district courts. In some instances the lawsuits were dismissed because the matter was not ripe. In *Seippel*, the court reasoned that even though the taxpayer had not yet had to pay, and might end up not paying, additional taxes, there had been other costs that had been paid. In another case, the court had ruled that a different taxpayer could not reasonably have relied on the law firm's opinion letter. The significance of the case is highlighted by this quote from Seippel's lawyer: "This will have overriding significance in the numerous tax shelter cases that are pending." We shall soon see.
- ***Tax Shelters***, by **Steve Johnson**: As part of the revivification of enforcement, 2005 saw continued IRS and Justice Dept. attacks on tax shelters. The Tax Court applied the economic substance doctrine against a lease-stripping shelter in CMA Consolidated, Inc. v. Commissioner, T.C. Memo. 2005-16, and the Second Circuit affirmed the Government's victory in Long-Term Capital Holdings, LP v. United States, 150 Fed. Appx. 40 (2005). Administratively, the IRS continued to identify allegedly abusive schemes; it suggested that it might reopen some "closed" shelter cases, Rev. Proc. 2005-32; and it announced a global settlement offer for 21 shelters, IR-2005-129; Ann. 2005-80; FS-2005-17.