

ABA TAX SECTION MIDYEAR MEETING

Tax Lawyers Seek Clarity On Economic Substance

By Patti Mohr — patriciam@tax.org

While lead taxwriters in the House and Senate wrestle with improving legislation to codify the economic substance doctrine, tax lawyers who debated the issue last month said a new statute would fail to clarify the law because the test itself is subjective.

Lead House and Senate taxwriters who introduced legislative proposals last year to codify and expand the court doctrine said last week that the proposals are still under review.

"It is something that I think needs to be discussed," said House Ways and Means Chair William M. Thomas, R-Calif. "We are going to continue to educate ourselves."

Senate Finance Committee Chair Charles E. Grassley, R-Iowa, said taxwriters are still looking at the issue of codifying the economic substance doctrine, which "raises many policy issues." A Senate tax aide said legislation would need to leave intact the courts' role in examining abusive transactions.

A Treasury official said he thinks codification of the economic substance doctrine may be too inflexible to deal with abusive transactions that can be controlled by final disclosure regulations and legislation dealing with shelter registration rules.

Speaking at a panel discussion at the American Bar Association Section of Taxation's midyear meeting in San Antonio, Julian Kim, an attorney-adviser for tax policy at Treasury, said Treasury is still in a "cleanup mode" combating abusive tax transactions, but that it would soon issue final disclosure regulations that would provide clearer, more objective rules. He said the final regs, due in February, would help Treasury and the IRS identify and respond to abusive transactions before they spread throughout the industry.

Kim said the disclosure regs would also allow cases to be properly presented in the court system, thereby allowing the system to apply the economic substance doctrine.

"We think the judicial doctrine will continue to play an important role as we do that," Kim said. He added later that clearer disclosure rules would help regulators identify abusive transactions and refine areas in the law that need additional clarity. He also called for legislation dealing with section 6111 tax shelter registration rules.

Kim said the "enormously complicated tax code" provides planners with opportunities for abusive tax shelters and that simplification could minimize the problem.

Debating the Doctrine

Tax policy analysts and practitioners offered assorted arguments for and against codifying the doctrines.

"This is not as radical a proposal as some think," said Martin J. McMahon Jr. of the University of Florida School of Law. He said that lawmakers could eliminate disparity among the various courts by choosing a case law it likes. He argued that tax planning is not an important societal value because it does not help society and said the system needs overarching standards.

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McMahon warned that codification would ensure the survival of the tax system, which he argues could collapse if the Supreme Court were to overturn the landmark case of *Gregory v. Helvering* (U.S. 465, 469-470, 1935). He also provided recommendations, such as limiting the loss deductions of profit-seeking transactions, to shut down specific abusive shelters.

Alan Wheable, of Toronto Dominion Bank, said Canada has a general antiabuse or general anti-avoidance rule (GAAR) that is a "bomb waiting to go off" because it was developed without administrative or judicial guidance.

"It is dedicated to the belief that everyone should maximize their taxes," Wheable said, adding that it is a dangerous provision that adds uncertainty and encourages bureaucratic abuse.

Court Doctrine Uncertainty

Tax lawyers speaking at another panel discussion said the courts' inconsistent use of the business purpose and economic substance doctrines makes it difficult to know what tax savings transactions are permissible under the law.

Mark H. Leeds, managing director of Deutsche Bank AG in New York, complained that the Circuit Court for the District of Columbia overturned a lower court's decision because it was "patently offended" by tax strategies found in internal memos. Leeds said that although he agrees with the ruling, he thinks the case (*Boca Investorings Partnership, et al. v. United States*; No. 01-5429 (Jan. 10, 2003), *Doc 2003-1175* (12 original

pages), or 2003 TNT 8-7) should warn practitioners against putting advice in writing.

Grassley said taxwriters are still looking at the issue of codifying the economic substance doctrine, which 'raises many policy issues.'

"I think it puts a substantial chill on tax planning," Leeds said. "It is so difficult to know when and how to say things to our clients."

But an IRS official said there is a fine line between structures in search of transactions and transactions in search of structures. "There is clearly a role for tax planning," said Cary D. Pugh, IRS Special Counsel to the Chief Counsel.

One problem with the case law is that courts in different parts of the country apply different standards for what constitutes economic substance, panelists said. But their biggest complaint was that the IRS and the courts abuse the doctrines by applying the subjective test before exhausting all objective evidence.

"If all else fails, they go right to economic substance," said Anthony J. Tuths, of Sidley Austin Brown & Wood in New York. ■

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IRS 'Scared to Death' of Disclosure Mistakes, Official Says

By Heather Bennett — hbennett@tax.org

As a result of taxpayer litigation and the potential for large punitive damages, the IRS takes section 6103 "very seriously," Michael J. Salem, an attorney in the Justice Department's tax division, said January 24.

At a panel discussion on disclosure of tax returns in nontax litigation at the American Bar Association Section of Taxation's midyear meeting in San Antonio, Salem discussed the three ways attorneys can get tax returns and tax return information from the IRS. Taxpayers or practitioners can make a standard request through current IRS procedures, subpoena the information in state or federal litigation, or make a request under the Freedom of Information Act.

Each method has advantages and disadvantages, Salem said, adding that the "great impediment" to getting the information regardless of the method is section 6103, which has broad prohibition against disclosure.

"The IRS takes 6103 very seriously," Salem said. "And the IRS is scared to death of making an illegal disclosure."

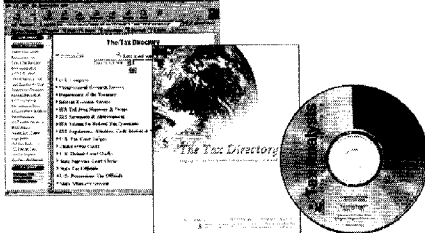
"That is absolutely correct," George Mason University School of Law Professor Leandra Lederman said. Lederman, who attended the panel discussion and is currently a visiting professor of law at the University of Texas School of Law, said the IRS is afraid that if it accidentally discloses taxpayer returns or information, it could face paying exorbitant damages. In the event of an IRS mistake, "there can be multimillion-dollar exposure for the Service," she added. Lederman said section 7431 provides for money damages for each of the IRS's illegal acts of disclosure.

Salem said the fastest way to obtain returns and return information is with a subpoena, but again, the party seeking the information is up against section 6103.

FOIA is a good tool if the party has the time and money to spend, he said, but it is also expensive and very time-consuming.

However, Salem added, the IRS "almost always wins FOIA litigation." ■

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