CAL
TAX NETWORK

Newsletter of the Tax Procedure and Litigation Committee
Taxation Section of the State Bar of California November, 2010

IN THIS EDITION

Robert Horwitz, Esq. Message from the Chair, regarding the upcoming Annual Meeting committee luncheon and other pending committee matters……………………………………….……Page 1

Schedule of Upcoming Meetings………………Page 2

Michel R. Stein, Esq. Minutes of the August 20, 2010 Committee Quarterly Meeting………......... Page 2

David M. Fogel, CPA, discusses a recent Tax Court case he litigated regarding the timely mailing rule……...…………………………………… Page 3

Bruce Givner, Esq., provides an update on the Economic Substance Doctrine – The Notice and the Directive………………………………….. Page 4

Robert Horwitz, Esq, Recent Cases of Interest …………………………………………….. Page 6

MESSAGE FROM THE INCOMING CHAIR

Greetings to the Tax Procedure and Litigation Committee!

I hope that all of you have signed up for the upcoming 2010 Annual Meeting of the California Tax Bar & California Tax Policy Conference (November 4 – 6 at the Loews Coronado Bay in San Diego). This conference should be another excellent event. I look forward to seeing you there and at our committee luncheon meeting on Friday, November 5.

The committee luncheon will be my first meeting as Chair. I look forward to being the Chair of the Tax Procedure and Litigation Committee during the 2010/2011 year.

The Committee had the good fortune to have Michael Sanders as Chair this past year. He set a high standard of excellence. On behalf of the entire Committee, I want to thank Michael for a job well done. I also want to thank Michel Stein for his work as 1st Vice Chair/Secretary and to David Klasing for his work as 2nd Chair/Network Editor. David prepared and edited the Committee newsletters.

During the coming year, Michel will serve as Chair Elect and David will serve as 1st Vice Chair/Secretary. Our 2nd Vice Chair/Network Editor will be Jane Becker. Like her predecessors, Jane will have to find interesting articles to publish quarterly. If you have an article you would like published in the Newsletter (or topics you'd like to see covered), please contact her.

I would also like to thank those who have helped make our quarterly Tax Network Newsletters and quarterly Committee meetings successful. Members of the Committee continue to play leading roles in the Tax Bar as educators and advocates (such as teaching at the SEI and the Annual Meeting and participating in the Washington D.C. Delegation).

The deadline for submitting topics for the 2011 Washington D.C. Delegation is approaching quickly. Please let me know of any topics you'd like the Committee to propose to the Executive Committee and if you'd like to write a paper based on the topic. We need to have our topics finalized soon.

A committee meeting agenda is included in the Meeting Information. If you have a case or issue you'd like to discuss, please email me at rhorwitz@taylorlaw.com. I'll ensure that the case or issue is included on the agenda to be passed out at the meeting.

I look forward to seeing all of you at the Annual Meeting.

Robert Horwitz

SCHEDULE OF UPCOMING MEETINGS:

November, 2010

2010 Annual Meeting of the California Tax Bar and California Tax Policy Conference November 4-6, 2010 at the Loews Coronado Bay in San Diego

November 5, 2010 Committee luncheon agenda:

1. Welcome 12:30 P.M.
2. Approval of Minutes.
3. Discussion of Topics for the Washington Delegation
4. Hot Topics
5. Adjourn 1:30 P.M.

MINUTES OF THE AUGUST 20, 2010, COMMITTEE MEETING

Submitted by Michel R. Stein, Esq.

The August 20, 2010 meeting of the Tax Procedure & Litigation Committee was held at the offices of Greenberg, Traurig at 153 Townsend Street, 8th Floor in San Francisco. The following were present: the Chair Elect, Robert Horwitz, who presided over the meeting, the First-Vice Chair, Michel Stein and the Second-Vice Chair, David Klasing. About 15 other Committee members were also present.

WELCOME

The Chair Elect welcomed the Committee members to the meeting.

NEXT COMMITTEE MEETING

The next meeting of the Committee was set for the Annual Meeting of the Tax Bars which takes place on November 4-6, in San Diego. The meeting with be on the 5th from 12:30 to 1:30 p.m.

REPORT OF ANNUAL MEETING

The Chair Elect invited members of the Committee to attend the Annual Meeting of the California Tax Bar to be held in San Diego on November 4-6, 2010. The Committee previously submitted numerous topics, which were described in prior minutes. The following programs will be sponsored or co-sponsored by this Committee: (1) IRS Employment Tax Enforcement; (2) International Tax Enforcement; (3) Ethical Considerations for Multiple Businesses and Individuals; (4) Mock Trial on Reasonable Compensation of Officers; (5) An Interactive Criminal Tax Panel; (6) Economic Substance and Uncertain Tax Positions; (7) Federal Procedural Roundtable; and (8) A Privilege Panel.

IRS SPEAKER - ARLETTE LEE - PUBLIC INFORMATION OFFICER

The Committee was fortunate to have Special Agent Arlette, the IRS Public Information Officer for Northern California, speak on the topic of Voluntary Disclosures.

Ms. Lee explained that CID's current role in processing voluntary disclosures is essentially the same as that prior to the

conclusion of the Services' Voluntary Disclosure Initiative (which ended on October 15, 2009). However, she noted the following changes: (1) taxpayers are no longer given any assurance on the amount of civil penalties that will be applied, (2) pre-clearances are now taking fifteen business days to complete, instead of 5 in the past, (3) some CID offices are now asking for the identification of banks as part of the initial disclosures (although hers is not one of them), (4) disclosures can now be processed in any city and (5) some CID offices will start requiring that optional letters be submitted within 45 days of pre-clearance.

The IRS now has a centralized number to call for information about the status of a voluntary disclosure. The contact person is Denise Nash (in Jacksonville, Florida); her phone number is (904) 665-1244. Ms. Lee advised that Form 2848 – Power of Attorney should specifically include the phrase "civil penalties." Amended returns can be processed through her office or by the Fresno Service Center.

Payment should be mailed to the following address: Internal Revenue Service, Voluntary Disclosure Program, P. O. Box 934, Austin, TX 78767-0934.

Ms. Lee also stated that she also processes voluntary disclosures unrelated to offshore accounts. She may be reached at 510/637-1031 or Arlette.Lee@ci.irs.gov.

HOT TOPICS

The following topics were discussed: (1) John Harbin discussed "sweeps" in San Diego pertaining to cash and currency transactions compliance issues and the border economy; (2) The group discussed the U.S v. Blair Stover Jr. injunction case, in which the United States sued two attorneys to block them from promoting alleged tax fraud schemes and ultimately obtained a broad reaching injunction (editors note: Robert Horwitz discusses Stover in Recent Developments); (3) Marshall Taylor asked whether any members had seen recent "Writ of Entry" or "Injunction Actions" in the context of employment tax cases; (4) Michelle Ferreira discussed the proposed California legislative changes found in AB 2498 pertaining to tax shelters, abusive transactions and proposed penalty provisions (technical comments on the bill were provided by the Taxation Section of the State Bar in August, 2010) and (5) Jim Counts discussed new California sourcing rules and sales factor provisions.

ADJOURNMENT

The meeting was adjourned and thanks were given to the participants and to Michelle Ferreira for the use of the conference room.

ARTICLES:

Recent Tax Court Decision Illustrates Timely-Mailing Rule

*By David M. Fogel, CPA*We all know that when filing documents with the IRS or U.S. Tax Court, "timely-mailing means timely-filing." The recent decision of *Van Brunt v. Commissioner*, T.C. Memo. 2010-220 illustrates this principle. A petition received 184 days after a notice of deficiency was issued was held to be timely filed as the facts established that the initial filing was on the 90th day

In this case, the IRS sent the taxpayers a notice of deficiency, giving them 90 days to file a petition with the Tax Court. The taxpayers' attorney prepared the petition, and on the 90th day he took the envelope to a UPS store and paid to have it sent by certified mail. An employee of the U.S.

Postal Service ("USPS") picked up the envelope later that day.

Nearly 3 months later, the attorney received the envelope back from USPS. The envelope (and its contents) had been torn in half and the right half (bearing the postmark and Tax Court address) was missing. The attorney contacted USPS for an explanation, and a USPS employee sent him a letter apologizing for damaging the envelope. The attorney promptly prepared a new petition and sent it to the Tax Court along with the damaged original envelope (and its contents), a letter explaining the circumstances, and the USPS employee's letter. The Tax Court received the package on the 184th day after the notice of deficiency had been issued.

The Service filed a motion to dismiss for lack of jurisdiction on the basis that the petition was filed late. Petitioners' counsel filed an objection. After a hearing, Judge Vasquez ruled that as the evidence indicated that the original petition had been timely-mailed, it was timely-filed.

The law in this area is well-settled. IRC §§7502(a)(1) and (d) provide that a petition properly mailed to the Tax Court within the 90-day period but delivered afterwards is considered timely. Treas. Reg. §301.7502-1(c)(2) provides that if the postmark on the envelope is missing or is illegible, and if the petition is sent by certified mail, the date of the postmark shown on the certified mail receipt shall be treated as the postmark date of the petition. Unfortunately, in this case, the attorney was unable to locate the certified mail receipt.

Several cases have held that if the postmark date is missing or is illegible, and the taxpayer does not or cannot produce the certified mail receipt, then the taxpayer may offer extrinsic evidence to establish what was or should have been the actual date of the postmark. See, e.g., *Mason v. Commissioner*, 68 T.C. 354 (1977); *Sylvan v. Commissioner*, 65 T.C. 548, 554 (1975); *Molosh v. Commissioner*, 45 T.C. 320 (1965); *Perry Segura Associates, Inc. v. Commissioner*, T.C. Memo. 1975-80; *Maddox v. Commissioner*, T.C. Memo. 2009-241. Judge Vasquez also noted that the envelope containing the petition doesn't have to be the original envelope in which the petition is received; an envelope that is timely-mailed, returned to the taxpayer and remailed to the Court also qualifies. See *Estate of Cranor v. Commissioner*, T.C. Memo. 2001-27.

It is interesting to note that before the IRS attorney filed the motion to dismiss for lack of jurisdiction, petitioners' counsel met with her and presented the same evidence that Judge Vasquez considered, i.e., the two affidavits, color photographs of the damaged original envelope and its contents and the letter from the USPS employee. Despite having this evidence, the IRS attorney filed the motion anyway.

A former IRS Counsel attorney informed me that the Service will file a motion to dismiss for lack of jurisdiction with any late filed petition in order to avoid a petitioner later arguing that a decision is void due to the court's lack of jurisdiction.

In reaching his decision, Judge Vasquez noted that there was substantial evidence which established that the original petition was timely-mailed. The attorney submitted an affidavit explaining the circumstances of preparing the petition and mailing the original envelope, the owner of the UPS store submitted an affidavit stating he had received the envelope from the attorney and that it was picked up by a USPS employee later that day, the attorney's contemporaneously-maintained postage log contained an entry reflecting timely-

mailing, and a USPS employee wrote a letter apologizing for damaging the envelope.

This case demonstrates that if you can prove that the petition was timely mailed, then it will be treated as timely filed, even if the circumstances cause a long or unusual delay in having the petition delivered to the Court.

Economic Substance Doctrine – The Notice and the Directive

By Bruce Givner, with Los Angeles law firm of Givner & Kaye.

It is far too soon to understand the impact of new IRC §7701(o), and its more troubling companions, §6662(b)(6)(i) and (ii), §6664(c)(2) and (d)(2). Some important commentators think that concern is overblown. "Codification Of The Economic Substance Doctrine – Much Ado About Nothing?" 112 JTax 324 (June, 2010). Others are less optimistic. "Living With (And Dying By) The Codified Economic Substance Doctrine," Martin J. McMahon, Jr. Professor of Law, University of Florida Levin College of Law Research Paper No. 2010-13 (June 11, 2010), at 20.

Almost exactly six months after the President signed the new law, the IRS issued its first formal guidance. Notice 2010-62, 2010-40 IRB (September 13, 2010). Applicable to transactions entered into on or after March 31, 2010, the Notice provides precious little guidance on important, open issues.

First, it confirms – to no surprise - that the IRS will now apply the conjunctive test: (i) a transaction must change, in a meaningful way (apart from Federal income tax effects), the taxpayer's economic position; *and* (ii) the taxpayer must have a substantial purpose (apart from Federal income tax effects) for entering into the transaction. The disjunctive test, previously permitted in the Fourth and Eighth Circuits, is no longer acceptable. Rice's Toyota World v. Commissioner, 752 F. 2d 89 (4th Cir. 1985). IES Industries v. U.S., 253 F. 3d 350 (8th Cir. 2001).

Second, consistent with previous statement by IRS officials and recommendations by academics, there will be no general administrative guidance about the types of transactions to which the economic substance doctrine either applies or does not apply. The four examples listed in the Joint Committee's explanation are not exclusive, implying that many common planning techniques will be respected. However, taxpayers and advisors are left to guess about which transactions will be respected. Can anyone be certain about a check-the-box election?

Third, the IRS will only consider the taxpayer's profit motive if the *present value* of the reasonably expected pre-tax profit is *substantial* in relation to the *present value* of the expected net tax benefits that would be allowed were the transaction respected. The Notice gives no guidelines as to an interest rate or a test of substantiality. Different taxpayers may use different interest rates. A given taxpayer may use a different interest rate in different circumstances. Different taxpayers may consider different pre-tax profits substantial. Again, taxpayers and their advisors are left to guess.

Fourth, the IRS intends to issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases.

Fifth, new subsection 6662(i) rewards a taxpayer who discloses a transaction by

reducing the accuracy-related penalty from 40% to 20% for any disallowance of claimed tax benefits due to a transaction lacking economic substance. For non-Reportable transactions, the disclosure rules currently required for the substantial understatement penalty of subsection 6662(d) are to be followed. Disclosure under Rev. Proc. 94-69 – now known as the Coordinated Industry Case Program (CIP) - is also acceptable. In both schemes, Forms 8275 and 8275-R are used. For Reportable transactions, the disclosure must meet both the requirements for non-Reportable transactions and those under the separate Reportable transaction rules. For this purpose Form 8886 is used.

Sixth, the IRS will not issue PLRs or determination letters regarding whether the economic substance doctrine is relevant to a transaction or whether a transaction complies with the doctrine's requirements.

Finally, the IRS requested comments by December 3, 2010, about the disclosure requirements, and the relationship of those requirements and the proposed uncertain tax position (UTP) schedule.

One day after the Notice was issued, Heather Malloy, the Commissioner of LMSB, issued "Directive For Industry Directors; Director, Field Specialists; Director, Pre-Filing and Technical Guidance; Director, International Compliance, Strategy and Policy." LMSB Control No.: LMSB-20-0910-024. It provides as follows:

> "To ensure consistent administration of the accuracy-related penalty imposed under section 6662(b)(6), any proposal to impose a section 6662(b)(6) penalty at the examination level must be reviewed and approved by the appropriate Director of Field Operations before the penalty is proposed."

Though this Directive is "not an official pronouncement of law, and cannot be used, cited, or relied upon as such," it suggests that the IRS is concerned that the new penalty be used sparingly. Though limiting approval of application of the penalty to twelve directors does not assure uniformity, it is a positive development.

The largest impact of the newly clarified and codified economic substance doctrine will certainly be from its strict liability penalty. How this will impact tax planning and actual business transactions remains to be seen. Let the games begin.

RECENT CASES OF INTEREST:

By Robert Horwitz, Esq.

Foundation of Human Understanding v. United States

Wonder whether an electronic ministry is a "church" for purposes of IRC §170(b)(1)(A)(i)? The Court of Appeals for the Federal Circuit answered the question in *Foundation of Human Understanding v. United States,* 2010-2 U.S.T.C. ¶50,581. The Foundation was established in 1963 and granted 501(c)(3) status in 1965. In 1970 and again in 1983, the IRS determined that the Foundation was not a "church." It then filed an action in Tax Court and was successful. The Tax Court ruled that the Foundation qualified as a church as it owned buildings where it conducted religious services several times weekly, had established congregations served by an organized ministry and operated a school (among other findings).

The Foundation did not, however, let well enough alone. In the 1990s, it incorporated its school as a separate entity that operated a non-denominational Christian school rather than one teaching the Foundation's doctrines. Then it sold the buildings where it held services and began to conduct its ministry through print, broadcast and the internet. This led to an IRS determination that while the Foundation was still exempt, it was not a church. This led to a second lawsuit. This time, the Foundation lost in Claims Court. The Federal Circuit affirmed.

The Federal Circuit noted that the IRS uses a fourteen criteria test to determine whether an entity is a church. Several courts, however, have adopted an "associational test" because the criteria used by the IRS could be seen as favoring some religious organizations over others, in contravention of the First Amendment protections of the Establishment and Free Exercise clauses. Neither the Code nor the regulations define "church," although there is a consensus in the courts that the definition of "church" is more restrictive than "religious organization".

What distinguishes a church from religious organizations is the method by which its religious purposes are accomplished. Adopting the associational test, the Federal Circuit held that to be a church required, at a minimum, a regular congregation and regular religious services. The Court rejected the Foundation's contention that a religious organization is a church if it has a body of followers who acknowledge an affiliation with the organization and its religious tenets, since this would encompass virtually every religious organization.

Although it held periodic seminars in various locations, the Foundation did not hold regular religious services during the three year period covered by the IRS audit. These seminars were not "regular" and did not involve a regular congregation, so the associational test was not met.

Finally, the Federal Circuit rejected the Foundation's argument that its electronic ministry, which included interactive services, including call-in shows, over the radio and the internet met the definition of a church. Its electronic ministry did not mean that listeners "associated with each other and worshiped communally." Thus the Foundation, while exempt from tax, was not a church. It thus is not exempt from filing informational returns under IRC §6033 and the IRS is not subject to the restrictions imposed by IRC §7611 in conducting audits and investigations of the Foundation.

United States v. Blair Stover Jr.

Close the barn door, the horses have all escaped. That is what it felt like reading *United States v. Blair Stover Jr*, 2010 U.S. Dist. LEXIS 81034; 106 A.F.T.R.2d (RIA) 5735 (W.D. Mo. 8/9/2010). Stover is an attorney who passed the CPA exam but was not licensed as a CPA as he did not meet the experience requirements. No problem, you don't need to be a CPA to convince people to evade taxes. Stover worked in the late 1990s until the summer of 2001 for Grant Thorton's Kansas City, Missouri, office. Like other Grant Thorton employees and partners, he pushed two tax avoidance structures to clients: the parallel C corporation structure and the ESOP/S Corporation structure. Under the parallel C corporation gimmick, a taxpayer who had a closely held corporation would set up a management company as a C corporation. The operating company would be on a tax year ending December 31 and the management company would adopt a tax year ending November 30. In December, the operating company would enter into an

agreement with the management company to provide management services for a set fee that was due in December. The operating company would accrue the expense for that year and the management company would not report any income until a year ending 11 months later. There was no business purpose for setting up the management company and the client's for whom the management company was set up did not have the operating company pay the management company or have the management company hire any employees.

A second structure was the ESOP/S Corporation. Here, a taxpayer who owned an S corporation would set up a second S corporation as a management company. The sole employees of the management company would be the owners of the operating S corporation. The management company would set up an ESOP whose sole beneficiaries would be the owners of the operating company. The two S corporations would enter into a management agreement. The operating company would deduct the fees called for under the management agreement. Since the management company was owned by an ESOP, the ESOP would not pay tax on the income reported by the management company. As in the first structure, the management company did nothing and there was no real change to the way in which the operating company carried on business. It just accrued a management fee that escaped taxation.

In 2001 Stover left Grant Thorton and went to work for Kruse Manella. He continued to sell the ESOP/S corporation structure and also began marketing another structure to owners of small businesses: the Roth IRA/S structure. Here, the stock in the management company would be owned by a Roth IRA whose beneficiary was the taxpayer. The taxpayer's operating company would accrue management fees which would escape current taxation because they were paid to an S corporation whose sole shareholder was a Roth IRA that was not subject to tax. At least that was the theory.

Besides setting up these structures for clients, the Court found that Stover was ethically challenged. Among other things, he failed to explain to clients the risk of structures he put them in, made misleading and false representations to clients and received (without clients' knowledge) a portion of fees paid to a company that set up corporations for the clients.

The court made a number of factual findings concerning Stover's knowledge, including that he knew or should have known that the parallel C corporation structure violated IRC §461, that the ESOP/S corporation structure was invalid under IRC §416, that under an IRS notice the Roth/S corporation structure was invalid, that the structures he set up did not have economic substance or engage in arms' length transactions and that he should have told this to clients, but did not do so. Based on these factual findings, the Court held that Stover had engaged in conduct that was subject to penalties under IRC §§6700 and 6701.

The Court then turned to the question of whether injunctive relief was appropriate to prevent recurring violations. Stover's position was that he had not promoted any of the abusive tax shelters that were the focus of the case for several years. While this was not disputed, the Court felt that this took too narrow a view of whether injunctive relief was necessary and appropriate. The Court noted that Stover moved from promoting one shelter to another over a period of years while at Grant Thorton and then at Kruse Manillo.

When Congress or the IRS outlawed one shelter, Stover would begin promoting another. It was only after he became embroiled in litigation concerning his promotion of abusive shelters that he stopped. Given this history, the Court found it evident that if not enjoined Stover would concoct new abusive schemes.

The scope of injunctive relief was broad. The Court enjoined Stover from "organizing, establishing, promoting, selling, offering for sale, or helping to organize, establish, promote, sell or offer for sale any tax plan involving the parallel C, ESOP/S, or Roth/S structures as described herein" Stover was also enjoined from "organizing, establishing, promoting, selling, offering for sale or assisting in any financial or tax related arrangement without submitting, in writing to an IRS designee, a detailed plan explaining the financial or tax arrangement and all steps necessary for the arrangement to be legal under the tax code." He had to get IRS approval before he could implement such a plan. He was required to advise the IRS of any business entity he formed or formed at his direction. He was required to provide the IRS with the names of any clients who retained him for tax advice and the names of other professionals' clients for whom he provided such advice. He was required to advise prospective clients that he needed to inform the IRS of his dealings with them and obtain their written consent to disclose that information. He was to provide a copy of the Court's decision to all current clients and other Kruse Manillo clients for whom he provided services.

Hongsermeier v. Commissioner

Does it never end? Well, maybe it has. *Hongsermeier v. Commissioner*, 2010-2 USTC ¶50,595 (9th Cir. 2010), could be the final chapter in the Kearsting shelter saga. Kearsting was a promoter who in the 1970s and early 1980s sold shelters based on a complex structure that involved the purchase of investments coupled with large interest deductions. The IRS determined that the transactions were shams and issued Notices of Deficiency to about 1800 investors who filed petitions in Tax Court. Because neither the parties nor the Court wanted to try 1800 cases, the parties selected "test cases" the results of which would bind all other cases. After a month-long trial, the Tax Court ruled in favor of the IRS. The problem, which came to light after the decision was entered, was that IRS counsel entered into a secret sweetheart settlement with Thompson, the petitioner in one of the test cases, who became the principal witness for the IRS. The Tax Court was disturbed by IRS counsel's conduct but refused to vacate its opinion that the transactions were shams. On appeal, the Ninth Circuit reversed. Finding that IRS counsel had committed fraud on the Court, the Ninth Circuit remanded the case to the Tax Court to enter decisions for the taxpayers that were the functional equivalent of the secret sweetheart settlement that the IRS had with Thompson. *Dixon v. Commissioner*, 316 F.3d 1041 (9th Cir. 2003).

On remand, the Tax Court held hearings to determine the basis of the settlement, which involved issues other than the Kearsting investments. It determined that the Government conceded 63.37% of the deficiency attributed to the Kearsting investment in its settlement with Thompson. The Tax Court therefore entered decisions in the cases equal to 36.63% of the deficiencies relating to Kearsting. The Tax Court also relieved the taxpayers of all non-Kearsting related deficiencies, finding it would be inequitable to require them to disprove the Commissioner's determinations more than

25 years after the fact, since memories were faded and records lost. It relieved the taxpayers of penalties, since the cases had been in audit and litigation for 25 years. It also abated interest for several years.

The Tax Court's determination was not good enough for a handful of the Kearsting investors, who appealed the decisions, claiming that there should have been no deficiencies at all. The taxpayers' initial argument was that the Tax Court's determination was in violation of the Ninth Circuit's mandate in *Dixon*. Not so, retorted the Ninth Circuit. It had directed the Tax Court to enter decisions in the cases that were the functional equivalent of Thompson's secret settlement. It would have violated the mandate to enter no deficiency decisions.

The taxpayers then argued that the Tax Court should have included additional items in the numerator to determine the percent of deficiency attributable to the Kearsting adjustment in the settlement. The Ninth Circuit noted that the deficiency asserted against Thompson was almost $80,000 and his settlement was for $30,000. The Court rejected the taxpayers' claim that the Tax Court should have added to the numerator the amount of taxes that Thompson never disputed and which he paid in the mid 1980s. It also rejected the claim that the Tax Court should have included in the numerator the tax savings Thompson would have received had he been able to utilize all of the interest deductions in one year in issue, rather than just a portion. The Ninth Circuit held that Tax Court was correct in not adding these, since they did not reduce Thompson's tax liability on the Kearsting items.

The Ninth Circuit also rejected the taxpayers' claim that the Tax Court should have added to the numerator late filing penalties that the Thompson would have had to pay had he not settled. It was well within the Tax Court's discretion not to add those penalties to the numerator, especially since it relieved the taxpayers of *all* penalties that the IRS had asserted.

The taxpayers asserted that Thompsons' liability for 1982 should have been added to the numerator. There was no deficiency for that year, which was barred by the statute of limitations absent fraud. The Ninth Circuit held that given the bar of the statute and the Tax Court's determination that Thompson did not intend to evade tax for 1982, the liability for that year was properly excluded. The Ninth Circuit also rejected the claim that the Tax Court should have included certain other years for which it could not locate records on the ground that the IRS hid or destroyed those records to cover up its attorneys' misconduct. The Tax Court did not abuse its discretion by relying only on available materials.

The taxpayers also asserted that the Tax Court should have allowed them to conduct discovery on allegedly continuing fraud by the IRS. The Court held that the Tax Court did not abuse its discretion in denying discovery, since the mandate did not require it to investigate allegations of continuing fraud.

Finally, the Ninth Circuit held that the Tax Court did not err in only stopping interest as of 1992 on the deficiencies, rather than 1986, since Thompson had paid the proposed deficiencies in that year. Unlike Thompson, the taxpayers did not prepay and had the continued use of their money.

Gross v. Commissioner

Exempted, excluded, what's the big deal? The Tax Court found it was a big deal in *Gross v. Commissioner*, T.C. Memo 2010-176. The taxpayer petitioned the Tax Court

to review an Appeals Office determination to allow the IRS to proceed with levy action to collect taxes that he owed for 1998 through 2001. Mr. Gross had an interest in a Director's Guild of America ERISA plan. He filed for bankruptcy under Chapter 7 on October 16, 2005. On his bankruptcy schedule, the taxpayer had listed the ERISA plan on his schedule of personal property and he listed it on his schedule of exempt property. On both schedules the debtor included a statement that the ERISA plan was excluded from his estate but was being listed in an "abundance of caution." At the time that his bankruptcy petition was filed, the IRS had not filed a notice of federal tax lien. The debtor was granted a discharge and all of his pre-petition tax debts were discharged.

The taxpayer claimed that as he had listed the ERISA plan in his bankruptcy and claimed it as exempt and as the IRS did not file a NFTL, it could not levy on the ERISA plan. The IRS asserted that an ERISA plan is per se excluded from, and cannot be part of, a bankruptcy estate; further, that even if it could be exempt property, the taxpayer expressly excluded it from the estate.

As the Tax Court explained, the difference between property that is exempt in bankruptcy and property that is excluded from the bankruptcy estate is significant. Exempt property is part of the bankruptcy estate that is administered by the trustee. Exempt property cannot, however, be used to satisfy prepetition debts during or after bankruptcy, except for debts secured by a perfected lien against the property and federal tax liens for which a NFTL was properly filed. Excluded property, on the other hand, is never part of the bankruptcy estate. A federal tax lien that arises under IRC §6321 and has not expired or become unenforceable remains enforceable against excluded property.

Under bankruptcy law, ERISA plans can be excluded from the bankruptcy estate. A debtor may claim retirement funds as exempt property. According to the Tax Court, although the debtor listed the ERISA plan on his bankruptcy schedules, he made it clear that he was excluding the ERISA plan from the bankruptcy estate. The ERISA plan was, therefore, excluded property and not exempt. As a result, the §6321 lien that arose and attached to the ERISA plan prepetition continued to attach to the ERISA plan after discharge. Thus, the IRS could levy on the plan.

NOTES FROM THE EDITOR

Articles and comments for the next newsletter are requested and are being actively solicited. If you have an article or comment, please contact me at my office 831-454-9415, or at becktax@inreach.com. **Thank you to everyone who submitted articles and comments for this edition!**

This publication is designed as a discussion vehicle for professionals. The ideas presented herein should be researched independently and adequately, and not relied upon. This publication is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the service of a competent professional should be sought.

Tax Network is published quarterly; contributions are encouraged.

Editor: Jane Becker Esq.

JOIN THE TPL COMMITTEE

Yes, I want to join the Tax Procedure & Litigation Committee of the Taxation Section of the State Bar and receive the quarterly newsletter. Please send the following information to the Committee Chair, Robert Horwitz, by E-mail rhorwitz@taylorlaw.com or U.S. mail.

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2010-2011
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