

# Taxation Law

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## President's Message

*by Jennifer A. Gellner*

We have tentatively scheduled our Annual Tax Luncheon for Friday June 1, 2007. We scheduled the event on a Friday to better facilitate participation by our members outside of Seattle and around the state. We are also working hard to schedule a CLE for that afternoon as an extra incentive for everyone to attend. We will send an e-mail to all of our members once the details are finalized.

The Tax Section website is updated and has a new look, and all of our Committee meetings and Section events are posted on the calendar. Please visit our website at [www.wsbatax.org](http://www.wsbatax.org). On the website, members can join list serves, which are used for each committee to advise members of upcoming meetings and events. All of our

meetings are open to the public, and we encourage our members to participate.

I have received several inquiries from members and students asking how to get involved and how to become a Tax Council member. The best way to get involved is to join the committee that relates to your practice or interests you. Participation in the committees can lead to an appointment to a committee chair position. The Tax Council is comprised of the four officers, the committee chairs & liaisons, and the at-large members. The officer positions progress up from treasurer to secretary to vice president to president with the position of treasurer being filled each year by a committee chair who has served for approximately three years. Thus, I served

on the Tax Council as newsletter editor, then website chair, and was then appointed treasurer, which began my climb to president. I have been involved with the Tax Council for approximately seven years.

All of our committee chairs are working hard to provide benefits to our members, and I would like to extend my appreciation and gratitude for their hard work. I encourage all members to get involved and attend our regular committee events and meetings.

Please contact me with any questions, suggestions, feedback, etc. at [jgellner@mhfmllaw.com](mailto:jgellner@mhfmllaw.com).

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## FASB Interpretation No. 48 - Accounting for Uncertainty in Income Taxes<sup>1</sup>

*by Neil D. Kimmelfiel – Lane Powell PC*

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One of the hottest topics in corporate tax departments in recent months is the implementation of Interpretation No. 48 ("FIN 48"), which was issued by the Financial Accounting Standards Board ("FASB") on July 13, 2006. FIN 48 provides definitive guidance on how to address uncertainty in accounting for income tax expense and related assets and liabilities under FASB Statement No. 109, *Accounting for Income Taxes* ("FAS 109"). As a result of the issuance of FIN 48, public compa-

nies and many other companies with audited financial statements are reevaluating their financial statement reporting of past tax-return positions and setting up processes for evaluating tax positions in the future.

This article summarizes significant features of FIN 48, with an emphasis on how FIN 48 will affect the services provided by outside tax counsel to corporate tax departments.

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## **FASB Interpretation No. 48 ... continued from previous page**

### **I. Background**

FAS 109 describes the objective of accounting for income taxes as recognizing “(a) the amount of taxes payable or refundable for the current year and (b) deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an enterprise’s financial statements or tax returns.”<sup>2</sup> FAS 109 also recognizes the following four “basic principles of accounting for income taxes”:

- a. A current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the current year.
- b. A deferred tax liability or asset is recognized for the estimated future tax effects attributable to temporary differences and carryforwards.
- c. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated.
- d. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.<sup>3</sup>

FAS 109 provides no guidance, however, on how to take uncertainties into account when determining “estimated taxes” and “estimated future tax effects.” Owing to this lack of guidance, FASB observed that “diverse accounting practices have developed resulting in inconsistency in the criteria used to recognize, derecognize, and measure benefits related to income taxes. This diversity in practice has resulted in noncomparability in reporting income tax assets and liabilities.”<sup>4</sup>

On July 14, 2005, FASB published an exposure draft containing a proposed interpretation of FAS 109. Under the proposed interpretation, a company would not have been permitted to recognize any benefit from a tax return position without making an affirmative determination that it was “probable” that the position would be sustained on the merits. Following sig-

nificant public comment, in November 2005 FASB decided to lower the standard for recognition from “probable” to “more likely than not.”<sup>5</sup> FIN 48 reflects that decision and other responses to public input and clarifies certain points that were ambiguous in the proposed interpretation.

### **II. Scope of Application**

FIN 48 applies to all companies that account for tax positions in accordance with FAS 109 – *i.e.*, any company with audited financial statements – including passthrough entities and nonprofit organizations if they are subject to tax. (¶ 1)<sup>6</sup> It applies to state, local, and foreign income taxes as well as federal income taxes. As a technical matter, it applies to all income tax positions, regardless of whether they are “uncertain.” (¶ 4, ¶ B10-12)

### **III. Effective Date and Transition**

FIN 48 is mandatory for a company’s first fiscal year beginning after December 15, 2006. (¶ 22) The first financial statement in which FIN 48 is adopted must apply the principles of FIN 48 to all tax positions, including tax positions taken on returns for prior periods. (¶ 23) The effect of applying FIN 48 to prior-period positions must be reported in the financial statement as an adjustment to the opening balance of retained earnings. (¶ 23) The need to apply FIN 48 to prior-period positions may compel the tax department to revisit past transactions and reporting decisions using the analytical methodology described below.

### **IV. The More-Likely-Than-Not (“MLTN”) Recognition Standard**

In order to report the benefit of a tax position on a company’s financial statement, the company generally must determine that it is MLTN that the position will be sustained, based on the technical merits of the position, if the taxing authority examines the position and the dispute is litigated to the court of last resort. (¶ 7, ¶ A2) The determination is made based all the facts, circumstances, and information available as of the reporting date.<sup>7</sup>

In applying the more-likely-than-not standard to a tax position, a company must assume that the position will be examined by the relevant taxing authority and that the authority will have knowledge of all relevant facts. (¶ 7(a))

FIN 48 does not require that a company obtain a tax opinion from outside counsel in order to establish that the more-likely-than-not recognition standard has been satisfied. When a tax position involves technical complexity or significant uncertainty, however, a tax opinion may be the best evidence supporting the company’s decision to recognize a tax benefit. In this regard, FIN 48 states:

The Board believes that a tax opinion can be external evidence supporting a management assertion and that management should decide whether to obtain a tax opinion after evaluating the weight of all available evidence and the uncertainties of the applicability of the relevant statutory or case law. Other evidence, in addition to or instead of a tax opinion, supporting the assertion also could be obtained; the level of evidence that is necessary and appropriate is a matter of judgment that depends on all available information.

(¶ B34)

The MLTN threshold for recognition under FIN 48 coincides with (1) the confidence level required by IRC § 6664(d)(2)(C) under the “reasonable cause” exception to the reportable transaction penalty under IRC § 6662A and (2) the comfort level that, under IRS Circular 230, may cause a tax opinion to be considered a “reliance opinion.” (Circular 230, § 10.35(b)(4)(i).) Circular 230, which governs the conduct of tax practitioners, requires rigorous due-diligence and opinion-drafting procedures (C230 Procedures) for reliance opinions and other so-called “covered opinions.” The full panoply of C230 Procedures generally is not required by the Internal Revenue Service in the case of an opinion that (1) is prepared solely to evalu-

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ate the merits of a position taken on an already-filed return (Circular 230, § 10.35(b)(2)(ii)(C)); or (2) is not intended to be used by the company for the purpose of avoiding potential tax penalties, and contains appropriate disclaimer language to that effect (Circular 230, § 10.35(b)(4)(ii)). However, many tax counsel believe that a significant subset of those procedures is required in appropriate cases as a matter of sound legal practice. Moreover, it is possible that auditors will question the value of an opinion supporting recognition of a tax position if the C230 Procedures are not followed. Accordingly, when requesting an opinion from counsel, it may be prudent for a company to discuss in advance – both with counsel and with the company’s auditors – the procedures to be followed by counsel in preparing the opinion.

A company’s auditors generally will expect to review opinions supporting the company’s tax positions, but the auditors will be unable to prepare such opinions absent audit-committee approval in accordance with Sarbanes-Oxley protocols.

The role of opinions from outside counsel in FIN 48 processes is discussed further in Section XII below.

#### **V. If the MLTN Standard Is Not Satisfied**

If a company determines that it is *not* MLTN that a tax benefit reported on its return would be sustained on audit, it may not report *any* benefit from the tax position on its financial statement unless and until such time as (a) the facts and circumstances (or law) change so that the tax position achieves MLTN status, (b) the position is favorably resolved after examination by the taxing authority, or (c) the statute of limitations for the taxing authority to challenge the position expires. (¶ 10(c))

#### **VI. If the MLTN Standard Is Satisfied – Measuring the Benefit**

If a company determines that a tax position satisfies the MLTN standard, the company must measure the amount of the benefit to be recognized in its financial statements. It must do this by determining the largest amount of the tax benefit from

the position that has more than a 50-percent likelihood of being realized after examination and, where dispute and compromise are likely, ultimate settlement with the taxing authority. (¶ 8)<sup>8</sup>

Determining the probability of realizing a particular amount of a reported tax benefit involves an assessment of matters such as management’s willingness to settle for less than the reported benefit and the company’s settlement experience with the taxing authority in examinations of similar positions. (¶¶ 23-24)

FIN 48 contains an example in which a company claiming a \$100 tax benefit on its tax return measures the amount of the benefit to recognize in its financial statement by determining the individual probabilities that, after examination, it will realize \$100, \$80, \$60, \$50, \$40, \$20, and \$0 of the benefit, respectively. (¶¶ A21-22) Those probabilities are 5 percent, 25 percent, 25 percent, 20 percent, 10 percent, 10 percent, and 0 percent. The company also determines that the “cumulative probability” of each outcome is the sum of the individual probabilities of (1) that outcome and (2) the outcomes in which greater benefits are realized. In the example, the company recognizes \$60 of the benefit in its financial statement, because the sum of the probabilities that it will recognize \$100 (5%), \$80 (25%), and \$60 (25%), respectively (*i.e.*, the cumulative probability that it will realize \$60), is greater than 50 percent, while the sum of the probabilities that it will recognize \$100 (5%) and \$80 (25%), respectively (*i.e.*, the cumulative probability that it will realize \$80), is not greater than 50 percent.

There is an element of extraordinary artificiality in this example. It is difficult to imagine, in practice, determining individual probabilities for particular outcomes in any rational manner. It is even more difficult to imagine determining individual probabilities for particular outcomes in a manner that permits those probabilities to be aggregated to a total of 100 percent.

In any event, notwithstanding the example in ¶¶ A21-22, there does not appear to be any requirement in FIN 48 that a company’s measurement process involve adding the individual probabili-

ties of separately handicapped outcomes. It should be acceptable for management to reach the same conclusion as the company in the example based on (1) a determination that the company would be willing to settle the item for \$60 or more and (2) an informed determination that \$60 is the highest amount that the taxing authority would MLTN agree to in settlement negotiations. If a company measures the likely outcome of settlement discussions using a “hazards of litigation” analysis that involves, for example, (1) the company’s own risk assessment and (2) a prediction of the taxing authority’s risk assessment, this is the kind of analysis that the company will likely apply.

Where a disputed tax position may be resolved under one of multiple alternative (*i.e.*, mutually exclusive) legal theories, and each theory entails a different dollar outcome, the hazards-of-litigation approach may be inappropriate (and there certainly will be no conceptual justification for cumulating the individual probabilities that each of the theories will be agreed to by the taxing authority and used as a basis for settlement). In such a case, if the company is willing to compromise the issue, the recognized benefit should be based on the most favorable settlement that would result from adoption of a theory that has more than a 50-percent likelihood of being accepted by the taxing authority.

Interestingly, if a company believes that the taxing authority will not accept or compromise a position and that the resulting dispute will be resolved through winner-take-all litigation, FIN 48 appears to require the company to recognize the entire benefit from the position. This is because, under such circumstances, there is no outcome other than 100% realization that has more than a 50-percent likelihood of occurrence. (Since the company has determined that the position satisfies the MLTN recognition threshold, the company has already concluded that there is more than a 50-percent likelihood of prevailing in litigation. Since the taxing authority will not compromise, the likeli-

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hood of realizing an amount of the benefit that is less than 100 percent is zero.)<sup>9</sup>

#### **VII. Classification of Unrecognized**

##### **Tax Benefits in the Financial Statement**

If less than 100 percent of the benefit from a tax position is recognized, the difference will give rise to a liability, a reduction of a tax refund receivable, a reduction of a deferred tax asset, or an increase in a deferred tax liability. Any liability arising from the excess of a tax benefit claimed on the tax return over the amount recognized in the company's financial statement should be classified as a current liability for any amount that is anticipated to be paid within one year (or the operating cycle, if longer). (¶ 17) Otherwise, it should be classified as a noncurrent liability. (See ¶ A11)

If the tax position relates to a timing item (*i.e.*, the claimed tax benefit, if disallowed, would give rise to a deferred tax asset), a liability must be recognized for the unrecognized tax benefit, but this FIN 48 liability will be offset by an increase to the corresponding deferred tax asset. (¶ A11) In other words, giving effect to FIN 48 with respect to timing items will not affect the balance sheet (except as to the recognition of interest and penalties), but may nonetheless require changes in accounting for unrecognized tax benefits from such items.

#### **VIII. Subsequent Recognition, Derecognition, and Changes in Measurement**

If a company has not recognized the benefit of a reported tax position because the position has not previously met the MLTN standard, but circumstances have changed so that the position now meets that standard, the tax benefit must be recognized in the company's financial statement for the period in which the change in circumstances occurs. (¶ 10) Similarly, if the benefit of a tax position was previously recognized in the financial statements because the position met the MLTN standard, but circumstances have changed so that the position no longer meets that standard, the company must "derecognize" the tax benefit in the period in which the

change in circumstances occurs. (¶ 11) A similar principle applies where changed circumstances cause a change in the company's measurement of the amount of a recognized tax benefit. (¶ 12)

FIN 48 states that a subsequent recognition, derecognition, or change in measurement "should result from the evaluation of new information and not from a new evaluation or new interpretation by management of information that was available in a previous financial reporting period." (¶ 12) The use of the term "should" rather than "shall" suggests that the stated principle is not absolute, but no guidance is given on appropriate departures from normal application of the principle. Also, there is ambiguity in the term "new information." Clearly, in appropriate circumstances, communications from a taxing authority about its settlement position with respect to a disputed position may be considered "new information." Not so clearly, "new information" arguably may include an opinion from outside counsel that is contrary to a legal analysis previously adopted by the company. Notably, the paragraph in FIN 48 governing this point refers to "facts, circumstances, and information," implying that "information" is not coextensive with "facts." Nonetheless, a company wishing to change its reporting of a tax benefit based on a new opinion from outside counsel would be well advised to discuss in advance with its auditors whether the opinion will be considered "new information."

#### **IX. Interest and Penalties**

##### **A. Interest**

If interest would be payable on an underpayment of tax, a company must recognize interest expense in its financial statement for each period during which the interest accrues under the applicable tax law, based on the difference between the amount of the tax benefit recognized in the company's financial statement and the amount claimed on its tax return. (¶ 15) Thus, if the company cannot conclude that it is MLTN that a tax position will be sustained, and the company therefore does not recognize any of the claimed benefit in

its financial statement, it must recognize the full amount of the interest expense that would result from complete disallowance of its tax-return position. On the other hand, if the company recognizes 60 percent of a claimed benefit in its financial statement, it must recognize interest expense equal to the statutory interest rate on tax deficiencies multiplied by 40 percent of the claimed benefit.

##### **B. Penalties**

If a tax position does not meet the minimum statutory threshold to avoid penalties, a company must recognize an expense equal to the amount of the statutory penalty for the period in which the company recognizes the benefits of the position. (¶ 16)

#### **X. Disclosure of Unrecognized Tax Benefits**

FIN 48 requires a company to include the following disclosures at the end of each annual reporting period (¶ 21):

- A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, including (1) the gross amounts of the increases and decreases in unrecognized tax benefits attributable to tax positions taken during a prior period, (2) the gross amounts of increases and decreases in unrecognized tax benefits attributable to tax positions taken during the current period, (3) the amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities, and (4) reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations.
- In the case of positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date, (1) the nature of the uncertainty, (2) the nature of the event that could occur in the next 12 months that would cause the change, and (3) an estimate of the range of the reasonably possible change

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or a statement that an estimate of the range cannot be made.

- A description of tax years that remain subject to examination by major tax jurisdictions.

The required tabular reconciliation is a presentation of aggregated information relating to the FIN 48 liability. Companies are not required to disclose information about individual unrecognized (or partially recognized) tax positions.

### XI. Impact on Tax Departments

Under the FIN 48 regime, tax departments will need to implement processes to handle the following matters on an ongoing basis:

- Since management will need to justify its decisions to recognize benefits from tax positions under the recognition standard and measurement principles of FIN 48, tax departments will need to (1) adopt procedures for determining the “unit of account”<sup>10</sup> for analyzing tax positions, (2) adopt procedures for identifying tax positions with sufficient uncertainty to warrant a full-fledged FIN 48 analysis, (3) document the analysis warranting each determination that a particular uncertain position is MLTN to be sustained, (4) document the methodology applied to measure the recognized benefit from each uncertain tax position, and (5) document the methodology used to calculate interest expense with respect to each unrecognized tax benefit.
- Since changes in circumstances may necessitate recognition, derecognition, or remeasurement of benefits from tax positions taken in prior-period returns, tax departments will need to maintain an inventory of all tax positions with a significant degree of uncertainty (even if the benefits from such positions were fully recognized), except tax positions that are outside the applicable statute of limitations.
- Because FIN 48 may increase the likelihood that tax benefits from transactions will not be recognized, tax departments

will want to apply a “FIN 48 filter” to contemplated transactions with significant tax uncertainties so that decisions not to recognize tax benefits do not come as a surprise to management.

In the transition period culminating in the issuance of the first financial statement adopting FIN 48, tax departments will need to inventory all previously reported uncertain tax positions for which the applicable statute of limitations is still open and apply the FIN 48 recognition and measurement analysis to each such position.

### XII. The Role of Outside Tax Counsel

Outside tax counsel can offer numerous types of assistance to companies implementing FIN 48. Every company's needs will be unique, but the following examples illustrate the range of possibilities:

- **Providing MLTN Opinions.** Although a MLTN tax opinion is not technically required to justify the decision to recognize a tax benefit, there are many circumstances in which an unqualified MLTN opinion from outside counsel will be valuable to a company's management and/or its tax department. Under FIN 48, tax departments will need to document a refined decision process for the recognition and measurement of the tax benefits of all tax positions. Where a tax position involves any significant amount of uncertainty, an outside opinion often will be the tax director's or CFO's best choice for documenting a decision to recognize all or part of the benefits from the position.
- **Providing “Should”-Level Opinions.** Although recognition of the benefit from a tax position does not require more than a MLTN level of comfort, a “should”-level opinion from outside tax counsel may enable a company to justify recording the full amount of the tax benefit in the FIN 48 measurement process. For example, if counsel provides a well-reasoned “should prevail” opinion with respect to a tax position, management may conclude that it is MLTN that the taxing authority will not chal-

lenge the position, resulting in a 100% measurement. Even if management is unwilling to reach such a conclusion, management still may decide that, in light of the should-level opinion, it will not compromise the issue for less than, e.g., 75% of the benefit. Such a conclusion should cause the company to record 75% of the benefit, if it believes the taxing authority will compromise the issue, and to record 100% of the benefit if it believes the taxing authority will not compromise.

- **Providing Less-Than-MLTN Opinions.** There may be situations in which an opinion from outside tax counsel will justify recognizing the benefit from a tax position even though the opinion provides only a substantial-authority comfort level with respect to an issue. Suppose, for example, that there are two entirely independent legal theories supporting a tax position, and outside tax counsel opines that it is not MLTN that either position would be sustained in litigation but also concludes that there is substantial authority for each theory, considered independently, and further concludes that, as to each theory, there is a 30% likelihood that the theory would be sustained in litigation. Under these circumstances, management may reasonably conclude that the MLTN recognition threshold is satisfied. (The probability that the position will be sustained is 51% — 30% plus 30% of 70%.)
- **Sharing Audit Experience.** In some situations, a company's outside tax counsel will be more experienced in negotiating with a taxing authority than the company's in-house tax staff. Management will take counsel's experience into account in making judgments about the likely outcome of settlement negotiations.

### XIII. Conclusion

Compliance with FIN 48 is now an important part of the tax function of every company with audited financial statements. Such companies may call on out-

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side tax counsel for additional services to assist with FIN 48 compliance. In order to provide those services effectively, attorneys providing tax services to such companies should become familiar with FIN 48.

- 1 This article is adapted from "Accounting for Uncertainty in Income Taxes – The Effect of FASB Interpretation No. 48," *The Tax Executive* (July-August 2006), by Neil D. Kimmelfield, Lewis M. Horowitz, and Paige L. Davis, all attorneys in the Tax Group at Lane Powell PC.
- 2 Financial Accounting Standard (FAS) 109, at 4.
- 3 *Id.*
- 4 Financial Accounting Interpretation 48, at 23 (¶ B2).
- 5 See [www.fasb.org/board\\_meeting\\_minutes/11-22-05\\_utp.pdf](http://www.fasb.org/board_meeting_minutes/11-22-05_utp.pdf), at page 2.
- 6 All "¶" references in this article are to paragraphs of FIN 48.
- 7 In a departure from the foregoing requirement of an "on the merits" determination, FIN 48 states that companies may take administrative practices of taxing authorities into account (in addition to legal authorities) as long as those practices are "widely understood." (¶ 7(c) and ¶¶ A12-A15)
- 8 FIN 48 ¶ 8 actually refers to "the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information." (Emphasis added.) Although there is no clear statement that measurement, like recognition, must be based on the assumption that the tax position in question will be examined, the italicized language suggests that this is FASB's intent.
- 9 For additional discussion of the measurement process, see Neil D. Kimmelfield, "FIN 48: Measuring Tax Benefits in the Real World," *Tax Notes*, October 30, 2006, at 501.
- 10 Issues relating to the identification of "units of account" are beyond the scope of this article.

## Tax Council Cases

### Assessment after Plan Confirmation Doesn't Violate Stay

In *United States of America v. White*, \_\_\_ F.3d \_\_\_, 2006 WL 2873264, 2006 U.S. App. LEXIS 25363 (11th Cir. October 11, 2006), the United States Court of Appeals for the Eleventh Circuit held that the IRS's tax assessment did not violate the automatic stay imposed by the debtor's Chapter 11 bankruptcy, even though the Bankruptcy Code at that time prohibited the making of tax assessments during the pendency of the automatic stay, since the Chapter 11 plan was confirmed and the debtor received a discharge, terminating the automatic stay, before the assessment was made.

The debtor's plan of reorganization was confirmed on May 18, 1994. The plan provided that title and ownership of the bankruptcy estate's assets would revert in the debtor as of the plan's effective date, defined as 60 days after the confirmation of the plan became final. A final decree was entered in the bankruptcy on December 12, 1994. The IRS later sued the debtor for collection, and on May 3, 2005, the United States District Court for the Northern District of Georgia held for the debtor that the assessment was void and the IRS was barred from making any additional assessments.

The district court agreed with the debtor that confirmation of a plan and the discharge granted on the date of confirmation have no effect on nondischargeable debts and, therefore, the automatic stay does not terminate for nondischargeable debts when the discharge is granted. The Eleventh Circuit rejected this argument, holding that the district court's decision was contrary to the law of the circuit, which recognizes that holders of nondischargeable debts may seek repayment when confirmation has been entered and the discharge granted. See *In re Gurwitch*, 794 F.2d 584 (11th Cir. 1986).

The district court agreed with the debtor that the assessment violated the automatic stay because it was made prior to the plan's effective date. The Eleventh Circuit disagreed. Under Bankruptcy Code section 1141(d)(1), the confirmation of a plan discharges the debtor from any

preconfirmation debts unless otherwise provided for in the plan. (Note that this case is not governed by BAPCPA and that under B.C. section 1141(d)(5), for cases filed on or after October 17, 2005, an individual debtor does not receive a discharge until all payments under the plan have been made.) The Eleventh Circuit held that merely providing for an effective date of the plan after the date of confirmation does not delay the confirmation of the plan. The court noted that the Bankruptcy Code contains numerous references to a plan's effective date and if Congress wanted to condition discharge on the effective date, it would have done so explicitly. In addition, the court reasoned that delaying the collection of nondischargeable debts until the effective date of the plan would be contrary to Congress's intent to ensure repayment of these debts in full sooner rather than later and should only be done by expressed court approval. Moreover, holders of nondischargeable debts may proceed against the debtor personally and against the debtor's assets and therefore need not wait until the effective date of the plan when the estate assets revert in the debtor.

The court upheld the Service's assessment and reversed the district court's judgment.

### IRS Need Not Consider OIC during Bankruptcy

In *In re: 1900 M Restaurant Associates, Inc.*, \_\_\_ F.Supp. \_\_\_, 2006 WL 2708681, 2006 U.S. Dist. LEXIS 67352 (D.D.C., Sept. 20, 2006), the United States District Court for the District of Columbia held that it is within the discretion of the IRS to return an offer in compromise as nonprocessable when the offer is submitted during bankruptcy. Further, the court held that the bankruptcy court may not compel the IRS to consider the offer pursuant to B.C. § 105(a).

The debtor filed for Chapter 11 bankruptcy in April of 2003. On January 26, 2004, the debtor submitted an offer in compromise to the IRS. On February 6, 2005, the offer was returned as

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nonprocessable partly because, under IRS procedures, the IRS may not accept for review an offer in compromise from a taxpayer with a pending bankruptcy case. The debtor then filed suit in the bankruptcy court for a declaratory judgment that the IRS's policy to return as nonprocessable an offer from a taxpayer in bankruptcy violates B.C. § 525(a), an anti-discrimination provision. The debtor requested that the bankruptcy court compel the IRS, pursuant to B.C. § 105(a), to "consider" its offer in compromise. The parties filed cross-motions for summary judgment. The bankruptcy court granted the Government's motion and dismissed the suit.

On appeal, the debtor first argued that the IRS's summary refusal to consider the offer in compromise based on the debtor's bankruptcy violated B.C. § 525(a), which prohibits discrimination against debtors on the basis that they are in bankruptcy. The court held that the IRS's refusal to consider the debtor's offer in compromise was not the type of act that is within the scope of section 525(a), as the IRS did not "deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant" in declining to consider the offer in compromise.

The debtor also maintained that B.C. § 105(a) allows a bankruptcy court to order the IRS to consider an offer in com-

promise. Under section 105(a) of the Bankruptcy Code, a bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." The court held that because there is no other express bankruptcy provision upon which the court was asked to act, the order the debtor sought was one of mandamus. Mandamus is available only if: (1) the appellant has a clear right to relief; (2) the appellee has a clear duty to act; and (3) there is no other remedy available to the appellant. The language of I.R.C. § 7122 indicates that the IRS "may compromise any civil or criminal case," suggesting that Congress intended to confer some discretion on the IRS; the court reasoned that "it logically follows that discretion to compromise carries with it discretion not to exercise that discretion." Treas. Reg. 301.7122-1(d)(2) provides that the IRS may refuse to process an OIC if it determines that the OIC is nonprocessable. The IRS's policy is not to process offers submitted while a bankruptcy case is pending. Instead the IRS would consider payment proposals as part of the plan confirmation process in bankruptcy. The court held that since here the IRS does not have a clear duty to act, which is the second prerequisite for mandamus relief, mandamus was not available.

## **Speak Out!**



**Wanted:** Lawyers to volunteer to speak to schools and community groups on a variety of topics.

For more information about the

WSBA Speakers Bureau, contact Dené Canter at 206-727-8213 or [denec@wsba.org](mailto:denec@wsba.org).

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Wills

Each topic is sold separately. Pamphlets are \$9 for 25, \$15 for 50, \$20 for 75, and \$25 for 100. Pricing for larger quantities is available on request.

To place your order or for more information, please contact the WSBA Service Center at 800-945-WSBA or 206-443-WSBA. Sales tax is applicable to all in-state orders.

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## Attorney/CPA Tax Clinic in Spokane

This coming year, Attorney-CPA Tax Clinic sessions will again be repeated via videotape at the Spokane office of Moss Adams LLP (18th floor of the Bank of America Financial Center – 601 West Riverside Avenue).

Sessions will be viewed on selected Thursday mornings at 7:15 a.m. as well as selected Wednesday afternoons at 4:00 p.m. Topics and dates will be announced via email to registrants as the videotapes are received from the WSBA Taxation Section.

For those needing to drive into downtown Spokane for the sessions, parking will be validated at the Bank of America Financial Center garage, entrance off Howard between Sprague and First.

To express interest in signing up for the Spokane presentations, please send an email to Karen Shea at Moss Adams ([karen.shea@mossadams.com](mailto:karen.shea@mossadams.com)) or call her at 509-777-0133.

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## Estate and Gift Tax Committee Report

by Luke Thomas

The Gift and Estate Tax Committee met at the office of K&L Gates on January 26, 2007. Gair Petrie, a national expert on the subject of estate planning and retirement plans who practices at Paine Hamblen in Spokane, gave a presentation to the Committee on the subject of recent changes in federal law affecting estate planning with retirement plans. The Committee also discussed the Washington State Department of Revenue's recently articulated position concerning the effects of the state's marital deduction on state estate taxes. A subcommittee was formed to prepare a response on behalf of the Committee to the Department of Revenue in anticipation of the Department's future release of an ETA addressing the marital deduction issue. The Committee's next meeting will be held on March 16, 2007, at 12:00 at the offices of K&L Gates. All interested members of the Tax Section are invited to attend.

## International Tax Committee Report

by Christopher Brown

The International Tax Committee is planning a number of exciting events for Tax Section members in 2007. The centerpiece of the year's events will be the annual International Tax Conference, scheduled for Friday, May 4th in downtown Seattle. This all-day event will be co-sponsored by the Washington Society of Certified Public Accountants. The topics for this event will include a review of tax issues related to international joint ventures, the new regulations governing branch currency gains and losses, and an overall review of recent international tax developments. We also plan to include a speaker addressing cross-border estate planning and a panel discussion on future tax reform issues in the international arena. Participants will get a chance to mingle with other tax lawyers and CPAs. CLE credits will be provided. We will post details of the speaker and topic schedule on our website soon.

We also plan to hold 2-3 lunch seminars as part of the International Tax Roundtable, also co-sponsored with the Washington Society of CPAs. Look for an upcoming lunch seminar dealing with how to handle an international tax audit, including one or more speakers from the IRS. In addition, I continue to have a great interest in recent developments in tax-deferral structures, including changes to the Subpart F rules and foreign tax credit planning. We may also organize a lunch event to focus on tax and practical issues in connection with sending employees on overseas assignments.

As always, we welcome your interest and participation in 2007. If anyone would like to participate as a speaker, co-speaker, or organizer, or if you would simply like to learn more about international tax, just let us know. The International Tax Roundtable is a great forum to meet other practitioners and to stay involved in a fascinating area of tax law.

## IRS Liaison Committee Report

Bob Boeshaar of IRS Counsel and Darek Jarski of LeSourd & Patten, P.S. are currently serving as co-chairs of the IRS Liaison Committee. The committee conducts regular meetings to discuss various topics pertinent to practice before the Internal Revenue Service. For our last meeting, Wednesday, January 17, 2007, Revenue Agent George Nunziata, the fraud technical advisor for the five-state region including Washington spoke regarding civil fraud examinations. Our next meeting will be at noon on Wednesday, March 7, 2007 in the Eagle Room in the Jackson Federal Building Cafeteria on the second floor of the Jackson Federal Building in Seattle. The topic and speaker are to be announced.

In addition, future meetings will include the following topics: issues surrounding reasonable compensation, injunctions of promoters of abusive tax schemes, and employer liability for the trust fund recovery penalty. The committee is also planning a reception for United States Tax Court Judge Mary Ann Cohen at Lajne Powell on June 13, 2007 from 5:30 pm. to 7:00 pm. The committee has also posted tax law updates, links to useful tax information, and materials from its past roundtable meetings at [www.wsbatax.org/irsLiaison.php](http://www.wsbatax.org/irsLiaison.php).

### IRS Liaison Committee

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## Pension Roundtable Report

by Richard A. Hopp

The Pension Roundtable continues to meet each month to discuss recent employee benefits law issues. The Pension Roundtable is a group of lawyers, actuaries and accountants who focus on the law of employee benefits. Tax law is the largest component of our focus, because employee benefits enjoy significant tax advantages. However, the group also focuses on other applicable law, especially federal labor law, that regulates or affects employee benefits. The group's activities are largely focused on self-education, although on occasion the group has recommended to the Tax Section revisions of state law that impact employee benefits, such as the exemption of certain retirement benefits from attachment or garnishment by creditors.

The group meets monthly, usually on the third Thursday. Anyone interested in more information about the Pension Roundtable should contact its chair, Richard A. Hopp (206) 386-7609 or [rahopp@stoel.com](mailto:rahopp@stoel.com).

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## Please Donate to the Tax Section Scholarship Fund

We will soon begin soliciting contributions to the Sixth Annual Tax Section Scholarship Fund. Through the generosity of the Tax Section members, the section has been able to assist five LL.M. students with their program tuition. Please remember the Tax Section Scholarship Fund as you prepare your 2007 budgets.

## Scholarship Committee Report

By Cori Flanders-Palmer

The WSBA Tax Section hopes to increase donations this year and interest in its LL.M. tax scholarship. In previous years the scholarship award has been \$5,000, but with more donations the Tax Section can increase its award to the deserving recipient. With rising tuition costs, the award alleviates some of the financial burdens that face future tax practitioners. Anyone who contributes to the scholarship fund will be supporting our future tax community as the majority of prior recipients have become practicing members of the Washington State Bar Association. We are currently accepting applications and donations to support the scholarship fund.

For more information, please visit the Scholarship link under our Tax Section website, [www.wsbatax.org](http://www.wsbatax.org).

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## State & Local Committee Report

by Robert Mahon

The State and Local Tax (SALT) Committee consists of members of the Tax Section who have an interest in Washington state and local taxes. The SALT Committee meets periodically with representatives of state and local government agencies to discuss SALT issue and serves as a forum for members to exchange ideas and concerns about the SALT practice.

On December 18, 2006, the SALT Committee was pleased to welcome the Washington Department of Revenue's tax policy team to a brownbag lunch meeting to discuss the Department's legislative agenda for the 2007 session and significant rule-making activity. Our guests from the Department included Leslie Cushman (deputy director), Russ Brubaker (senior assistant director, tax policy), Jan Bianchi

(assistant director, interpretations and technical advice), and Mark Craig (assistant director, legislation and policy). The meeting covered a variety of topics, including healthy discussions about the Department's streamlined sales tax bill, a proposed import-export bill, and a proposed bill related to the taxation of printing and publishing. Following the meeting, the Department followed up by forwarding copies of the Department's legislative package.

On January 10, the SALT Committee held its first meeting of the new year. This meeting was an open forum for members to raise and discuss state and local tax issues. Topics covered at the meeting included recent court of appeals decisions in *Community Telecable of Seattle v. Seattle* and *KMS v. Seattle*, Department of Revenue publication of tax determinations, and Board of Tax Appeals practice issues.

The SALT Committee's next meeting is scheduled as a brownbag lunch on Wednesday, March 7, from noon to 1:30 p.m. at the offices of Perkins Coie, 1201 Third Avenue, Suite 4800, Seattle. We will be joined by Mary Barrett, assistant director of the Department of Revenue's Appeal Division, to discuss the results of the Appeals Division's taxpayer satisfaction survey, settlement, and other Appeals Division issues. In April, the SALT Committee will be scheduling a meeting with the representatives of the Department of Revenue's Taxpayer Services Division to discuss letter rulings and the division's efforts to identify and fill gaps in understand Washington tax treatment.

Members of the Tax Section who are interested in state and local tax issues should contact Bob Mahon at [rmahon@perkinscoie.com](mailto:rmahon@perkinscoie.com) or (206) 359-6360 to be added to the SALT Committee's email list. Members can also check the Tax Section's calendar at [www.wsbatax.org](http://www.wsbatax.org) to check future meeting times, locations, and subjects. All Tax Section members are welcome!

## Website Committee Report

by Jaret Coles

The Website Committee is responsible for acting as a liaison between the WSBA Tax Section webmaster and members of the Tax Section. During the last few months the Tax Section's website was completely revamped to make it more user friendly. Committee meetings, continuing legal education courses, and Tax Section events are now posted on an easy-to-read calendar. Additionally, various committees provide relevant tax materials and hyperlinks on their respective individual web pages (e.g., the IRS Liaison Committee).

If you desire to participate in a committee, we encourage you to visit [www.wsbatax.org](http://www.wsbatax.org) and click on membership. While there you can join list serves for the various committees in order to receive up to date information about committee events. Additionally, if you join the general list you will receive information about special Tax Section events and developments. Please visit [www.wsbatax.org](http://www.wsbatax.org) for more information.

## CLE Credits for Pro Bono Work?

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APR 8(e) creates a limited license status of Emeritus for attorneys otherwise retired from the practice of law, to practice pro bono legal services through a qualified legal services organization.

For further information contact Sharlene Steele, WSBA access to justice liaison, at 206-727-8262 or [sharlene@wsba.org](mailto:sharlene@wsba.org).

## Service Center... at your service!

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We're here to serve you! The mission of the WSBA Service Center is to respond promptly to questions and requests for information from our members and the public.

Call us Monday through Friday, from 8:00 a.m. to 5:00 p.m., or e-mail us at [questions@wsba.org](mailto:questions@wsba.org).

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The Taxation Law newsletter invites its readers to submit articles, items of interest, and announcements for publication in upcoming issues. Share your expertise, your knowledge, and your insights for the benefit of your colleagues.

So you have an idea you would like to flesh out, or a finished article ready to go?

Please contact the officers of the Tax Section by sending an e-mail from the Taxation Section website at the following link:  
[wsbatax.tripod.com/officers/roster.htm](http://wsbatax.tripod.com/officers/roster.htm).

We would like to read what you have to say.

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