

# TAX NETWORK

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

APRIL 2008

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## MESSAGE FROM THE CHAIR

THIS IS A GREAT YEAR! The last meeting in Sacramento was very informative.

Sincere thanks go out to Steve Toscher, who organized the tremendous panel on federal and CA state criminal tax. The FTB was a great host, and we had the opportunity to greet Steve Sims, who had recently become the new FTB Taxpayer Advocate.

Our committee is sponsoring a number of papers on the D.C. Trip - you will get a report at the meeting. Our members are in the process of preparing to present at the upcoming Income Tax Seminar in Northern and Southern California, and the committee is now preparing for the upcoming annual tax section meeting. We have nine topics and our program coordinators have jumped right into the task of pulling together their panels - updates all at the May 2nd meeting.

We are also taking on some new challenges, and great appreciation goes to those who are facilitating these efforts. For instance, we need to update our member list, and we need your help to do it. Please share your contact information with Kornelia

Davidson (at [kdavidson@browtaxlaw.net](mailto:kdavidson@browtaxlaw.net)). And we have also stepped up to the challenge of providing more committee input into the California Tax Lawyer. If you want to know more, contact: Daphna Bar-Tal (at [dbartal8@gmail.com](mailto:dbartal8@gmail.com)); Jane Cassidy (at [cassidy1615@comcast.net](mailto:cassidy1615@comcast.net)); or Michael Sanders (2nd Vice-Chair) (at [sanders@taxatty.com](mailto:sanders@taxatty.com)).

At our May 2nd meeting, we are anticipating another great program. We'll hear from Theresa A. McGill, a member of the IRS team of Bank Secrecy Act Specialists. So come on out to The Proud Bird, where there'll be good food and camaraderie to boot.

## NEXT MEETING DATE:

August 15, 2008 San Diego

See you in Los Angeles!

- LaVonne

THERE ARE OPPORTUNITIES TO PARTICIPATE OR PROVIDE INPUT. If you have a suggestion or a question, or if you would like to contribute to an upcoming newsletter, or if you would like to get more involved, you can reach out to any of the committee chairs as follows:

LaVonne Lawson, Chair - 310.440.0400 or email at [ll@lawsontax.com](mailto:ll@lawsontax.com)

Kornelia Davidson, First Vice Chair - 415.318.8700 or email at [kdavidson@browntaxlaw.net](mailto:kdavidson@browntaxlaw.net)

Michael Sanders, Second Vice Chair - 425.288.9807 or email at [sanders@taxatty.com](mailto:sanders@taxatty.com)

Robert Horwitz, Third Vice Chair - 714.546.0445 or email at [rhowitz@taylorlaw.com](mailto:rhowitz@taylorlaw.com)

MAY MEETING INFORMATION

**TAX PROCEDURE & LITIGATION  
COMMITTEE MEETING**

**MAY 2, 2008 - 11:00 a.m. to 3p.m.**

**The Proud Bird Restaurant**

**1022 Aviation Blvd.**

**Los Angeles, CA 90045**

**310.670.3815**

11:00 a.m. Greetings and Committee Member  
Introductions (15 min.)

Approval of Minutes from November 2, 2007  
Meeting ( 5 min.)

Meeting Locations (10 min.)

Member List ( 5 min.)

California Tax Lawyer Articles (10 min.)

Recess - Get Lunch (15 min.)

12:00 p.m. Lunch & Speaker Panel Presentation  
(1.5 hr.)

Speaker:

Theresa A. McGill, Senior Bank  
Secrecy Act Specialist, IRS SB/SE

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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 distributed with the understanding that the publisher 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.

Articles & Letters to the Editor are welcome.

1:30 p.m. Recess (5 min.)

Updates: (25 min.)

1. D.C. Trip
2. Income Tax Seminar
3. Annual Tax Section Meeting

New Business (10 min.)

2:10 p.m. Hot Topics Discussion

3:00 p.m. Adjourn

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**SCHEDULE OF NEXT MEETINGS**

San Diego, August 15, 2008

Berkeley, November 2008 (Annual Meeting  
at the Claremont Hotel)

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**FEBRUARY MEETING MINUTES**

*Submitted by Michael R.E. Sanders*

The Tax Procedure and Litigation Committee (“Committee”) met on February 1, 2008, at the offices of the Franchise Tax Board, Valley Quail Room, California Building Town Center, Sacramento. The Chair, LaVonne Lawson, Esq., called the meeting to order at 11:15 a.m. Present were members of the Committee, including the Chair, Chair-Elect Kornelia Davidson, Esq., 2nd Chair Michael R.E. Sanders, Esq., and 3rd Chair Robert Horwitz, Esq., and Daniel Gonzalez, Supervising Special Agent, Franchise Tax Board Investigations Bureau, Scott O’Briant, Special Agent in Charge, Oakland Field Office, Internal Revenue Service, Robert Twiss, Assistant U.S. Attorney, and several staff members from the FTB.

**Welcome & Introductions –**

LaVonne welcomed the Committee members and guests from the FTB, IRS, and U.S. Attorneys

Office. A special welcome was given to the new California Taxpayer Advocate, Steve Sims.

### [Minutes of November 2, 2007, Tax Procedure & Litigation Committee Meeting –](#)

The Minutes of the November 2, 2007, meeting were read, and after review and discussion were accepted.

### [Update of Bylaws of the Committee –](#)

Joseph Broyles discussed the Bylaws of the Committee, and the additional changes he had made. In the November 2, 2007, meeting, the Committee had approved the name of the Committee to be “Tax Procedure and Litigation Committee”; however, Joseph explained that the official name was actually “Procedure and Litigation Standing Committee of the Taxation Section of the State Bar of California,” and therefore he had included the foregoing name in the draft Bylaws. There was discussion about the name, and how the Taxation Section listed the various standing committees on its website. The Chair agreed to investigate this matter and to verify whether the Committee name should be the “Tax Procedure and Litigation Committee” or “Procedure and Litigation Standing Committee of the Taxation Section of the State Bar of California.”

During the November 2, 2007, meeting, the Committee had discussed the need to better explain how the elected Third Vice-Chair moves through the chain of chairs to serve eventually as the Chairperson. During the February 1, 2008, meeting, members discussed the further need to include in Section 4 of the draft Bylaws provisions addressing the progression of the Vice-Chair to Chair. With respect to Section 3 of the draft Bylaws, the commencement term of membership in the Committee was discussed, and it was proposed that membership should commence upon payment of Bar dues together with membership fees. The Committee agreed that Joseph should make these proposed

changes, and that such would be reviewed and considered by the Committee at its next meeting. A few edit/spelling errors that needed to be corrected were also pointed out by the members of the Committee.

### [Updates](#)

#### [SEI –](#)

John Harbin informed the Committee that his topic at SEI was on marital dissolution, property settlement, and innocent spouse issues; he mentioned that about 25 were in attendance. Another presentation at SEI regarded egg shell audits, the civil fraud exception, among other things, and that about the same number attended.

#### [D.C. Papers –](#)

The Chair informed the Committee that three papers are scheduled.

Sharyn Fisk will present her paper, together with Heather Lee, on the “reasonable standard” of Section 6676, Erroneous Claim for Refund or Credit Penalties. She explained that under 6676, a penalty is imposed on any taxpayer filing an erroneous claim for refund or credit equal to 20-percent of the disallowed portion for refund or credit for which “there is no reasonable basis” for the claimed tax treatment. This “reasonable standard” also brings in the new standard of section 6694.

John Harbin will present his paper on Section 66(c)(4), Equitable Relief claims, and judicial oversight of adverse spouse claims. Section 66© provides relief from income tax liability to taxpayers domiciled in a community property state, but who do not file jointly. Under 6015(f), the IRS may grant equitable relief if, taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or deficiency (or

any portion thereof). His paper proposes a fix to changes made two years ago. If John is unable to make the D.C. trip due to a conflict, LaVonne will present the paper.

Steve Mopsick informed the Committee that the Chief Judge of the Tax Court had given him an assignment regarding new rules and procedures. Steve further informed the Committee that he may need help with respect to these comments because the comments should represent the consensus of the Committee rather than his personal opinion. Steve proposed that there should be some kind of protocol to follow when the Committee is required to propose a position on tax issues. Steve suggested that the Committee should be involved in this paper, and a procedure should be instituted to clear what is being proposed in the various papers to be presented, and in particular to help prepare a page or two of comments for him to take back to the Court regarding: a final status report of the new procedures; the positive aspects of the California pro-bono program for the Tax Court and clinics (to put on the Tax Court website as a model for other State Bar jurisdictions); on-line registration of tax practitioners; and any other matters members of the Committee may have for consideration by the Tax Court. Karen Hawkins agreed to assist in this regard, and James Counts proposed that an e-mail be sent to the membership for additional comments, and suggestions. LaVonne proposed that a sub-committee be organized. The Committee agreed to the e-mail proposal. The deadline for suggestions is April 1, 2008.

#### [Income Tax Seminar in June of 2008 –](#)

LaVonne asked for topics for a Committee sponsored Income Tax Seminar in June of 2008. Wendy Abkin, Michelle Ferreira, LaVonne Lawson, and Dennis Brager volunteered as speakers for Northern and Southern California, respectively. Topics will be determined.

#### [Speaker Presentation –](#)

Scott O'Briant, Special Agent in Charge Oakland Field Office, Internal Revenue Service, Daniel Gonzalez, Supervising Special Agent, Franchise Tax Board, Robert Twiss, Assistant U.S. Attorney, Sacramento, and Steven Toscher, of Hochman Salkin Rettig Toscher & Perez, P.C., presented a panel discussion regarding an Update on Criminal Investigations – Federal and State. Among other things, the panel covered the IRS's involvement in undercover operations regarding abusive tax-scheme organizations, including abusive off-shore schemes, and the intent of the IRS to discourage and defer non-compliance of taxpayers, the number of cases brought by the IRS, the number of indictments, and convictions (in fiscal year 2007, for example, the conviction rate was 82-percent, and the average sentence was 40 months); the returning prevalence of abusive tax schemes; examples of local cases; the standard of criminal prosecution of employment tax cases relating to non-existent subcontractors, false business expenses characterized as employee expenses; money laundering; tracking of funds in Saudi Arabia in conjunction with the Joint Terrorism Task Force; a comparison and contrast of the IRS and FTB approaches to criminal prosecution (including tax evasion, false returns, the underground economy, non-filers), the use of Nevada "nominee" corporation schemes and other types of entity schemes. In addition, the "good-faith" defense was discussed, and the sentencing guidelines. In particular, Daniel Gonzalez prepared a PowerPoint presentation covering the mission and goals of the FTB Investigations Bureau, its organization, background of the typical FTB Investigator, types of investigation cases (internal affairs, refund fraud, tax evasion, false return – at any given time about 400 cases are under investigation or in the criminal court system) – and FTB Investigations Bureau activity, statistics regarding executed search warrants, arrests, and assessments, and case examples. The panel

concluded with a discussion of dual and successive prosecution issues, and the use of prosecutorial discretion of the same offense and conduct under federal and California law (the “Petit Policy”). In addition, to a copy of the PowerPoint presentation being provided to each member in attendance, a 38 page handout relating to federal matters was provided.

### Topics for the State Bar Annual Meeting and Annual Meeting of the California Tax Bar –

Before discussing possible topics for the State Bar Annual Meeting and the Annual Meeting of the California Tax Bar, members questioned whether all the Committee members were receiving the Committee Newsletter, and action should be taken to ensure that the Committee has every members’ e-mail addresses.

The Chair informed the Committee that the Committee needs five to seven topics for the State Bar Annual Meeting and nine to 12 topics for the Annual Meeting of the California Tax Bar. The Committee members suggested an ample number of topics. It was decided that an e-mail should be sent to all Committee members requesting additional ideas and volunteers to make the presentations.

### Hot Topics –

The Committee members discussed:

- The jury verdict in the *Wesley Snipes* case.
- Joseph Broyles mentioned an OIC case relating to the value of an entire business (appraisals), and fast track mediation – whether the IRS should obtain an appraisal or the taxpayer – the taxpayer had made a deposit in a valuation case, and now does not have the money to hire an appraiser.
- James Counts mentioned the appellate decision upholding the Superior Court ruling in *Northwest Energetic Services, LLC v. California Franchise Tax Board*, which held that the LLC is a tax and that it violates the “fair apportionment” requirement under the US Constitution; however, the decision relates to an out-of-state taxpayer (the lower court refused to rule on an LLC solely or partially in California), so we are still waiting for other cases; the FTB has not yet decided whether it will appeal to the California Supreme Court.
- Whether mortgage debt forgiveness may still be taxable to California residents despite the federal legislation.
- Inconsistent tax treatment on settlement initiative by different tax authorities, including excise taxes.
- 30-day letter report – reasons for adjustments are now short, single paragraph explanations, instead of detailed explanations, resulting in Appeals not knowing what the government’s position is; it seems to be a “boiler plate” untrained agent problem that needs to be corrected.
- The Taxpayer Advocate for the FTB, Steve Sims, responded to questions for the FTB Taxpayer Advocate, and, among other things, told the Committee members that the division chiefs want a pro-active Taxpayer Advocate, who will go out and speak and educate. The contact telephone number is 916-845-7576.

## Schedule of Meetings –

The next meeting will be held on May 2, 2008, in Los Angeles – the specific location to be announced. A meeting will be held in August on August 10, 2008, in San Diego. The Annual Meeting is set for November 6, 2008, in San Francisco (the Annual Meeting will be November 6, 7, and 8).

The Committee Meeting adjourned at 3:00 p.m.

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## Articles

### A GUIDE TO MEDIATION FOR THE STATE TAX LITIGATOR

*By Barbara L. Rosenfeld, J.D., LL.M. © 2008 All Rights Reserved*

This article describes the use of mediation as a potential alternative to litigation in tax cases docketed in the Los Angeles Superior Court (LASC). It contains: (1) an overview of mediation, highlighting its application to tax cases and advantages over litigation, (2) the procedure to access mediation in the LASC, and (3) a mediator's recommendations to maximize its value.

#### **Mediation as an alternative to litigation and other dispute resolution processes**

Alternative dispute resolution, or "ADR," is a growing method of resolving cases (or portions of cases) before trial. ADR processes became available in the LASC in the mid-1970s. The three most popular methods of resolving cases without trial are: (1) settlement (with or without court intervention), (2) arbitration, where a neutral panel of one or more arbitrators makes a decision on the merits of a case, and (3) mediation.

Mediation is "a process in which a neutral person or persons facilitate communication between the disputants to assist them in reaching a mutually

acceptable agreement<sup>1</sup>." A "neutral" or mediator is an objective person who can provide a "reality check" and help ferret out a mutually satisfactory resolution.

The LASC first offered mediation services in 1995, and it quickly became the most utilized method of ADR. Unlike arbitration or trial, mediation does not involve a third party decision-maker. Instead, the mediation process is more similar to a settlement conference with two significant differences.

Both mediation and settlement conferences aim to reach a mutually agreeable resolution to some or all issues in dispute. Mediation, however, is based on the legislative mandate of voluntary participation and self-determination.<sup>2</sup> Secondly, mediation relies on counsel to negotiate the terms of an agreement with the assistance of a third-party "neutral" rather than relying on judicial intervention.<sup>3</sup>

#### **When mediation works in a tax case**

Historically, the government agencies involved in litigating tax cases were slow to accept mediation. In the last 5 years or so, the Attorney General's Office, Tax Division, as well as the Franchise Tax Board have accepted and even welcomed its use in appropriate state tax cases in the LASC.<sup>4</sup> City Attorneys also use mediation to resolve local tax disputes.

Mediation can be a useful tool for resolution of fact intensive tax cases, but is of limited value in cases involving constitutional challenges, statutory interpretation, or those where the result is likely to have significant precedential value.<sup>5</sup> Where a party asserts a constitutional challenge or statutory interpretation already addressed by the courts, however, a neutral may be able to highlight the futility of re-litigating the issue in the absence of new, sound arguments.

When a government entity that requires settlement approval by an elected official or legislative body is a party, a representative with authority to recommend such an agreement is required to attend the mediation.<sup>6</sup>

### **The advantages to mediation over litigation**

Mediation has many advantages over litigation in tax refund cases as well as in other civil cases. It saves time and money, provides a confidential forum, a flexible process, and an outcome controlled by the parties.

Since mediation does not require significant court resources, it can be used to expedite conflict resolution and reduce the court's backlog from an ever-growing caseload.<sup>7</sup> In addition to relieving the courts of a drain on resources, mediation permits the parties to resolve their cases at a lower cost.

In the LASC, neutrals on the Pro Bono Panel<sup>8</sup> provide 3 hours of hearing time at no cost. The LASC also has a Party Pay Panel of mediation neutrals. The Party Pay Panel mediators have more experience with court-connected mediation, and may charge \$150 an hour (collectively) for 3 hours of hearing time.

If the parties access the Pro Bono Panel or Party Pay Panel without full resolution of the issues, the parties may retain a mediator privately. Likewise, if the parties choose to continue beyond the 3 hours of free or reduced rate mediation, they may agree to retain the neutral at his or her regular rate.<sup>9</sup> In general, the parties share the fees for mediation neutrals, ranging from \$200 to \$1,000 an hour, equally.

Litigation is public. Court records can be sealed by court order but are otherwise public documents.<sup>10</sup> Likewise, court proceedings such as motions and trials, are generally open to the public. Mediation offers a way to deal with litigated disputes in private.

This is especially appealing in the tax area, where sensitive financial information is often at issue. There are specific court rules and code sections to ensure the confidentiality of mediation proceedings.<sup>11</sup>

In mediation, the parties control the process and their own outcomes. The parties can choose the neutral, the date for hearing, the time to be spent at mediation, and the approach they want to use. There is no settlement unless all parties to the dispute reach an agreement. The parties may include provisions that go beyond what a court is authorized to order, provided they can agree on the terms.

### **The procedure to access mediation in the LASC**

The LASC has jurisdiction at the trial court level for three categories of civil cases: small claims (involving claims for relief of \$7,500 or less for individuals and \$5,000 or less for corporations or other entities), limited jurisdiction (involving claims for relief of \$25,000 or less), and general or unlimited jurisdiction cases (involving claims for relief in excess of \$25,000). The rules for accessing ADR vary depending upon the type of case involved.<sup>12</sup> This discussion will focus on general jurisdiction cases.

The first formal opportunity for parties to choose mediation in general jurisdiction cases occurs at the Case Management Conference, which the court schedules within 180 days after a complaint is filed.<sup>13</sup> Typically, the parties have not completed their formal discovery at this juncture, so it may be difficult to utilize mediation unless the facts have been developed during the underlying administrative proceedings.

The court may also refer a case to mediation at the pre-trial conference. At this point, it is likely that the parties have completed discovery and incurred substantial costs. Alternatively, the parties can

stipulate to court-connected mediation prior to the Case Management Conference.<sup>14</sup>

The court will issue an order and set a completion date after the parties agree to or are referred to LASC mediation.<sup>15</sup> The parties may then choose a neutral from one of the court's panels, or notify the court of their decision to use a non-panel member. The parties can select a neutral by name or expertise using the ADR website or ask the ADR staff to randomly assign a neutral from either the Pro Bono or Party Pay Panel.<sup>16</sup> California Rules of Court govern the standards of conduct for mediation neutrals<sup>17</sup>

### **How to maximize the value of your mediation session: a neutral's perspective**

There are two primary approaches to mediation: evaluative and facilitative. The facilitative approach promotes communication and negotiation between the parties. The evaluative approach provides a "reality check" regarding the legal and evidentiary merits of the case. Mediators can combine these approaches. (There are other approaches that are likely to have limited application in a tax case.) The parties should consider selecting a mediator experienced in the approach they prefer.

If the parties want to use an evaluative approach, they will want a mediator with a tax background and litigation experience. If the parties prefer a facilitative approach, they will want a mediator with consensus-building, communication and "people" skills. In all cases, the parties will want a mediator in whom they have trust and confidence.

There is no restriction on "ex parte" contact with the mediator. Counsel should take advantage of the rules regarding confidentiality to be candid about the strengths and weaknesses in the case, as well as any client control issues. When possible, use a joint discussion for logistics (e.g., time, place, special

needs, etc.)

Most mediators require briefs in advance of the mediation. If the parties are to exchange briefs, they can submit confidential matter to the mediator in a separate brief. It is essential that you alert the mediator to what is confidential. Mediators return the briefs to the parties or destroy them at the conclusion of the final session.

The brief is an important vehicle to identify issues amenable to resolution - both substantive and procedural. Through mediation, counsel can identify undisputed issues to provide the basis for a stipulation of facts. If substantial discovery remains outstanding at the time of mediation, the parties may be able to reach agreement on a discovery schedule.

Following the mediator's introduction, mediation often starts with a "joint session" in which all parties and their counsel meet together in one room. Generally, counsel for plaintiff will start with an opening statement, followed by counsel for the defendant.

There are several reasons to use a joint session. For the taxing agency, its representative can add a human dimension to the agency. For counsel, the joint session provides an opportunity to "showcase their talents" for their clients, to assess the witness potential of the opposing party, and to watch opposing counsel "in action."

However, when dealing with antagonistic parties or counsel, a joint session may further polarize them. In those cases, it may be best to dispense with the joint session and go directly into separate caucuses or a joint session of counsel without clients.

"Separate caucuses" are held between one party, counsel and the mediator. They enable the mediator to listen to each side without interruption, and to recommend how best to communicate with the other

side. More importantly, given the confidentiality provisions discussed above, separate caucuses give counsel an opportunity to candidly discuss the likely outcome at trial. In cases with "client control" issues, it may make sense to request a separate caucus with the mediator and counsel.

Most counsel are comfortable allowing their clients to have an active role during the separate caucuses; some counsel find active client participation to be valuable in the joint sessions, as well. Participation by the clients allows them to feel "heard." Frequently, clients make valuable contributions to the resolution process. Give some thought to the various options, prepare your client in advance, and let the mediator know which approach will work best for you.

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The key to the success of mediation rests in its flexibility to expand the options for conflict resolution beyond the win-lose option of a trial. No hard and fast rules apply. The mediation process accommodates the myriad variables presented by each unique person and each set of facts.

The LASC Pro Bono and Party Pay Panels provide counsel with a cost-effective alternative to the time and cost of a trial, while enhancing the possibility for a negotiated compromise. In addition, these panels provide counsel with an opportunity to evaluate the effectiveness of local mediators for future sessions or cases.

<sup>1</sup> California Code of Civil Procedure, section 1775.1(a). See also: California Rules of Court, rule 3.800(2).

<sup>2</sup> California Rules of Court, rule 3.853.

<sup>3</sup> Retired judges often establish mediation practices where they serve as private, paid neutrals.

<sup>4</sup> Another avenue for resolution of multistate tax cases is the

Multistate Tax Commission's ADR program, with the advantage of bringing together several states to achieve an equitable result for a taxpayer.

<sup>5</sup> The Franchise Tax Board Litigation Coordinator shared this view.

<sup>6</sup> California Rules of Court, rule 3.874 and LASC Local Rule 12.15.

<sup>7</sup> The LASC serves the 9.5 million people of Los Angeles County with approximately 430 appointed judges and 100 commissioners. It is divided into twelve geographic districts and includes over 48 courthouses from Pomona to Santa Monica and from Lancaster to Long Beach. Approximately 30,000 of the estimated 160,000 civil cases filed in LASC annually come through the LASC ADR department. See generally: LASC Alternative Dispute Resolution (ADR), "Neutral Resource Manual," pages 2 and 7.

<sup>8</sup> The LASC Court Executive Committee recently increased the minimum Pro Bono Mediation Panel training requirement from 25 to 40 hours, which must include 20 hours of core/classroom training and 20 hours of practical training.

<sup>9</sup> LASC Local Rule 7.12(k)(5).

<sup>10</sup> California Rules of Court, rule 2.500 et seq.

<sup>11</sup> See California Evidence Code sections 703.5, 1115-1128 and 1152; Code of Civil Procedure, sections 1775.10 and 1775.12; and California Rules of Court, rule 3.854.

<sup>12</sup> LASC Local Rule 12.0; Code of Civil Procedure, sections 1775.3-1775.5.

<sup>13</sup> LASC Local Rule 7.9(a), (b), © and (f), and California Rules of Court, rules 3.720 to 3.730.

<sup>14</sup> California Rules of Court, rule 3.726 and LASC Local Rule 12.16.

<sup>15</sup> LASC Local Rules 7.9 and 12.2.

<sup>16</sup> Parties can use the Name Search or Random Search functions at: [www.lasuperiorcourt.org/adr/UI/INDEX.ASPX](http://www.lasuperiorcourt.org/adr/UI/INDEX.ASPX).

<sup>17</sup> California Rules of Court, rule 3.850 et seq.

## RECENT CASES OF INTEREST by Robert Horwitz

When is a tax refund suit not a tax refund suit? The Federal Circuit ruled that it was not a tax refund suit when it was brought under the Export Clause of the Constitution. Wrong, says a unanimous Supreme Court in *U.S. v. Clintwood Elkhorn Mining Co.*, 2008 U.S. LEXIS 3472 (S.Ct. 4/15/08). The case involved a tax under IRC §4121(a)(1) on the sale of coal, including exports, that Congress enacted in 1978. Coal companies routinely paid the tax for a number of years. In 1998, a district court held the tax was unconstitutional to the extent that it applied to coal exports under the Export Clause. See *Ranger Fuel Corp. v. U.S.*, 33 F.Supp.2d 466 (E.D.Va. 1998). The IRS acquiesced in the district court's ruling.

The taxpayers filed refund claims for tax paid on coal exports in 1997, 1998, and 1999, which were allowed by the IRS. They also filed suit in the Court of Federal Claims for tax paid in 1994, 1995, and 1996. The Claims Court and the Federal Circuit held that the case arose under the Export Clause of the Constitution and, therefore, was not subject to the refund procedures contained in the IRC. Instead, the Tucker Act applied, and the Court had jurisdiction to order a refund of taxes paid 6 years prior to the date the case was filed, regardless of whether a claim for refund was filed.

The Supreme Court reversed, holding that under the clear language of IRC §§6511 and 7422, a taxpayer seeking a refund of tax must file a timely claim for refund before it can file a refund suit. Under §7422, no suit for the recovery of any tax that was allegedly assessed and collected illegally or erroneously can be maintained unless a refund claim was filed. Sec. 6511 required that a refund claim be filed within the latter of three years of filing of the return or two years of the payment of the tax. These provisions would be meaningless if a court could assert Tucker

Act jurisdiction regardless of whether a taxpayer filed a timely refund claim.

The Supreme Court also rejected the taxpayers' argument that the Tucker Act applied whenever the tax involved in unconstitutional. The Court noted that its decisions under the Anti-Injunction Act carved out an exception for cases where it was "clear that under no circumstances could the Government ultimately prevail . . . the attempted collection may be enjoined if equity jurisdiction otherwise exists. In such a situation the exaction is merely in 'the guise of a tax.'" The *Ranger Fuel Corp.* decision was relied on Supreme Court cases decided in 1996 and 1998 that clarified the reach of the Export Clause. The Court stated that since the taxpayers had paid the tax until after the *Ranger Fuel Corp.* decision, they could not claim that, at the time they paid the tax for the years in issue, it was clear that the IRS could not prevail under any circumstances.

*Boulware v. United States*, 2008 U.S. LEXIS 2356 (S. Ct. 3/3/08). It came out of the Ninth Circuit, so the result before the Supreme Court was predictable. The Supreme Court unanimously vacated and remanded a Ninth Circuit ruling that the taxpayer had to have a contemporaneous intent that funds received from his corporation be a "return of capital.

Boulware was originally convicted of tax evasion in district court in Hawaii. According to the government, Boulware, stole money from his closely-held corporation, Hawaiian Isles Enterprises (HIE), to give to his girlfriend. He did not report the money as income on his tax returns. The Ninth Circuit overturned the lower court conviction because a state court judgment had been excluded from consideration by the jury.

At retrial, the district court refused to allow the defense to present evidence that money Boulware received from HIE was a nontaxable return of capital. Boulware was again convicted of filing a false return and tax evasion. In 2006, the Ninth

Circuit affirmed the conviction and sentence. 470 F.3d 931. The Ninth Circuit held that its prior cases required a taxpayer in a criminal tax proceeding to show that he intended funds received from a corporation to be a return of capital at the time of the distribution.

The Supreme Court granted Boulware's petition for certiorari. The Court held that a taxpayer who claimed return of capital treatment in a criminal tax evasion case under IRC §§7201 does not have to produce evidence of his intent at the time of the distribution. The Court stated that the "right touchstone" should be the economic substance doctrine laid out in the *Frank Lyon Co.* case. The economic reality of a transaction should govern, which in this case, could mean that Boulware received a distribution even if no formal declaration was made. As the Court noted, "Even diverted funds may be seen as dividends or capital distributions."

To properly characterize the transaction requires a court to look to the key definitional terms in the tax code. Whether there was a deficiency is determined by §§301 and 316, which "together thus make the existence of 'earnings and profits' the decisive fact in determining the tax consequences of distributions from a corporation to a shareholder with respect to his stock." Whether a taxpayer received a taxable dividend or a return of capital from a corporation is determined by the existence of earnings and profits, as well as by the amount of a taxpayer's stock basis, rather than by what a taxpayer's state of mind was when a corporate payment occurred.

Indeed, there was "no textual hook for the contemporaneous intent requirement" that the Ninth Circuit applied. While the crime of tax evasion requires willfulness as an element that the government must prove, it also requires that a tax be owed. The Court concluded that it lacked a full record to decide whether HIE had earnings and profits to be able to treat the distributions as a dividend, and so remanded the case back to the

Ninth Circuit for further proceedings consistent with the Court's opinion.

Can't a taxpayer trust his "financial advisor" anymore? Apparently not. *U.S. v. Miller*, 2008 U.S. App. LEXIS 5745 (5<sup>th</sup> Cir. 3/18/08), is another case where a taxpayer was convicted based on "intent." Miller had been a client of Charles Matsch, a self-styled "financial planner" who advised his clients to transfer assets overseas to keep them beyond the reach of the IRS. Miller owed the IRS more than \$2 million in back taxes, penalties and interest. He had an IRA with about \$1 million. On the advise of Matsch, Miller transferred the funds to an overseas bank account, under the pretense that it was to pay a debt owed to an offshore company. The account was to be held for Miller's benefit and use. Unbeknownst to Miller, however, Matsch swindled the money.

Miller then submitted an offer in compromise to the IRS together with a Form 433-A that did not list the offshore account. The IRS began an investigation concerning what happened to the money in the IRA. After learning that the funds had been transferred overseas to keep them out of the hands of the IRS, the government prosecuted Miller for tax evasion. The government's theory of the case was that Miller submitted the offer in compromise and financial statement with the intent of evading and defeating the payment of tax, because he failed to disclose his interest in the foreign bank account to which the funds were transferred.

The Fifth Circuit affirmed Miller's conviction for tax evasion in violation of IRC §7201. The Court held that what was important was Miller's intent when he submitted the offer. That, factually, he did not have the funds that had been transferred overseas was irrelevant. The question was whether Miller believed that he had access to and control of the funds when he submitted the offer. Since there was sufficient evidence to prove that he believed he controlled the funds at the time of the offer, his

conviction was supported by substantial evidence. The Court did not discuss the Supreme Court's decision in *Boulware*.

Will the U.S. petition for certiorari to resolve this split in the circuits? In *Philadelphia Marine Trade Assoc./Int. Longshoremen's Assoc. v. U.S.*, 2008 U.S. App. LEXIS 8031 (3<sup>rd</sup> Cir. 4/15/08), the Third Circuit sided with the Eighth, Ninth and Tenth Circuits in holding that the common law "mailbox rule" is supplemented, and not preempted, by IRC §7502. The Second and Sixth Circuits have held that §7502 preempts the common law mailbox rule with regard to tax matters.

The plaintiffs in *Philadelphia Marine Trade Assoc.* were a multi-employer trust fund set up to administer longshore workers' vacation benefits and the plan administrator. Penalties had been assessed against and paid by the trust fund. The trust fund claimed that it learned about the payment of the penalties after its accountant reviewed the plan administrator's records. It therefore contacted IRS collections. An officer of the plan administrator testified that a refund claim had been mailed by first class mail to the IRS collections office after the contact with collections and several weeks before the expiration of the statute of limitations. A month later, the plan administrator and its accountant held a meeting with IRS employees concerning the penalties. The IRS claimed that it could not find a copy of the refund claim in its files. Since the refund claim was allegedly sent first class mail, the taxpayer did not have a certified mailing receipt. The government claimed that §7502 was the sole method by which the taxpayer could prove that it filed a timely refund claim; since a copy of the claim was not in the IRS's files and the taxpayer did not have a certified mailing receipt, it therefore could not prove that it filed a timely refund claim.

The Third Circuit reversed summary judgment in favor of the government on two grounds. First, the fact that the IRS collection officer remembered talking to the taxpayer and its accountant about the penalty several weeks before the refund claim was allegedly filed and that IRS employees met to discuss the penalties after the refund claim was allegedly filed was sufficient direct evidence of timely filing to make summary judgment improper. Second, because the taxpayer's testimony of timely mailing was corroborated by other evidence, it could rely on the common law mailbox rule under which it is presumed that a document that is sent through the U.S. mails is delivered within the normal course of business.

KPMG wins again!! In *Sala v. United States*, Docket No. 05-00636 (Colo. 4/22/08), the taxpayers sold options in a corporation for a \$60 million gain. They entered into a "Son of BOSS" foreign currency options investment transaction called the "Deerhurst Program" that generated a loss sufficient to offset the gain. The Salas timely filed an original return for 2000 that reported the loss; in November, 2003, they filed an amended return which did not claim the loss and paid over \$23 million in tax. They then filed a claim for refund.

After trial, the district court held that the transaction was not devoid of economic substance. Finding the taxpayer's testimony that he entered into the transaction as part of a long-term plan to generate profits, the court viewed the "investment" as one transaction, refusing to divide it into discrete steps in a plan to reduce taxes. It therefore held that (1) the taxpayers invested in Deerhurst for the purpose of making an economic profit, and not solely to reduce taxes, (2) their basis in Deerhurst was as claimed on their original return, (3) Treasury Regulations §1.752-6(b)(2) was invalid, and (4) the taxpayers were entitled to a refund as sought, plus interest thereon.

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