2003 YEAR-END UPDATE

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I. YEAR IN REVIEW

A. Jobs Growth Tax Relief Reconciliation Act of 2003

1. It was the best of times; it was the worst of times." (Dickens, "A Tale of Two Cities.")

2. For tax practitioners, 2003 was both the best of times and the worst of times. The Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "Act"), enacted earlier this year, produced the third largest tax cut in the history of this fair land of ours. In addition to lowering tax rates across the board, the Act makes profound changes in the taxation of investments, particularly capital gains and dividends, thus providing practitioners with new, exciting planning opportunities for their clients, the "best of times."

3. The Act, however, is the third major piece of tax legislation in the last three years, adding to the burden on practitioners in getting and remaining current. In addition, several 2003 tax return forms will look significantly different than the 2002 version of those forms, and 2003 Forms 1099-DIV should be unusually interesting, given the changes in the law. Tax filing season could be the "worst of times."

4. My outline on the important provisions of the Act is available on request.

B. Other General Tax Observations

1. 2003 marked a notable shift in the Internal Revenue Service's activities away from "customer service" and back to enforcement and compliance.

2. This change was particularly pronounced in the tax shelter area where important new regulations on shelter registration and changes to Circular 230 were promulgated.

3. The Internal Revenue Service has also begun devoting considerable resources to new information return initiatives, employment tax enforcement and attacks on abusive offshore transactions.

4. As if the Act were not enough, Congress and the Bush Administration were working on other tax matters at year-end. Although the Energy Bill appears dead for 2003, legislation dealing with extenders and the simplification and enhancement of retirement savings programs were being considered, and the Military Family Tax Relief Act was recently enacted. Your author believes that Congress and the Administration have done enough of the people's work for one year and that it's time for them all to go home so that the citizens can be safe again!

5. 2003 also saw many tax developments in addition to the Act, some of the most important (and some of the dumbest) of which are set forth below for your edification and humor.

II. TAX SHELTERS AND OTHER BAD THINGS

A. The Basics

1. The scandals which tainted several of America's "finest" corporations and the burgeoning budget deficit (as well as the appointment of a new Commissioner of Internal Revenue) have prompted the Internal Revenue Service to step up its attacks on tax shelters.

2. Interestingly, the Government's focus has widened to target individuals, as well as corporations. Major initiatives in 2003 included unreported offshore income and slavery reparation deductions. (Indian casino gambling revenue appears safe for now, except perhaps in California.)

3. The Internal Revenue Service has promised increased criminal prosecutions for tax crimes. Moreover, return preparers, as well as taxpayers, have become (to use the current jargon) "persons of interest" to the Government. In IR-2003-23, the Service announced that in the first quarter of 2003 alone, it had referred 79 cases involving return preparers to the Department of Justice. 2002 prosecutions more than doubled from 2001 levels.

4. The Internal Revenue Service announced on April 15, 2003 that "intensive efforts" to pursue 78 tax shelter promoters were underway, accompanied by 239 summonses to obtain investor lists. April 15th Internal Revenue Service announcements, like opening day in Major League Baseball, are both eagerly awaited and a sure sign of Spring.

5. In its annual budget request seeking more resources, the Internal Revenue Service identified the following "key areas of noncompliance", i.e., high-income, high-risk taxpayers and businesses, abusive tax avoidance schemes and offshore trusts. Nothing like stating the obvious.

6. The Tax Division of the Department of Justice, not to be outdone, announced the following criminal tax enforcement priorities: (i) employers who fail to withhold or pay payroll and income taxes; (ii) return preparers who prepare fraudulent returns; (iii) tax protestors claiming frivolous and discredited reporting positions; and (iv) taxpayers using trusts and offshore accounts to evade tax.

B. These are a Few of My Favorite Schemes

1. The "Section 861" scam, apparently heavily promoted, relies on the dubious proposition that United States citizens are taxable only on foreign-source- and not on United States source-income. ("What a country!") The Internal Revenue Service and Justice Department have both sought injunctions and brought charges against promoters of this frivolous position.

2. The refund attributable to the "tax credit" for slavery reparations.

3. The use of offshore payment or credit cards linked to bank accounts containing unreported income. In January of this year, the Internal Revenue Service launched a voluntary compliance initiative aimed at getting these taxpayers back into compliance by agreeing not to prosecute those who voluntarily came forward with the details of these accounts. According to the Internal Revenue Service, approximately 1,200 taxpayers took advantage of this program and paid more than $100 million in back taxes, interest and penalties. (Fortunately or unfortunately for your author, Mrs. Cohen already had a more than adequate supply of domestic charge cards.)

4. In Notice 2003-34, the Internal Revenue Service reminded taxpayers that purported small insurance companies organized offshore principally, it would appear, to invest in hedge funds must actually be insurance companies to qualify for federal income tax exemption under §501(c)(15). (Unlike the three prior abuses, this "technique" is actually rather clever if structured properly and, to my knowledge, is being heavily promoted to physicians.)

5. Another rather clever approach involves purported employee leasing arrangements involving offshore deferred compensation plans. This "technique" has actually been around for awhile and is also typically promoted to physicians. See Notice 2003-22. The Internal Revenue Service deems this planning to be abusive.

6. Major United States corporations are claiming large tax breaks through leasing schemes which, according to Senate Finance Committee Chairman Charles Grassley, involve highways, airports, trains and water lines. Promoters pay an upfront "accommodation fee" to municipalities to permit the promoter to lease, for example, water lines or subways, to corporations in a manner which purportedly entitles the corporations to depreciate these taxpayer-funded infrastructure items. My own personal favorite is the Alamodome in San Antonio, which is reported to have been

leased under one of these deals. (It apparently worked on several levels, inasmuch as the Spurs were the 2003 NBA Champions.)

C. 2003 Inductees to the Tax Abuse Hall of Shame

1. "We really mean it; I swear."

   a. In questioning by a Senate Subcommittee, executives of KPMG testified on November 18th that while the firm had in the past taken aggressive tax positions and encouraged the sale of these products to clients, its efforts to develop and sell risky tax reduction strategies "are over."

   b. A PWC tax partner in the New York Office said that "our partners were adamant that we get out of this business immediately," so PWC entered into a closing agreement with the Internal Revenue Service involving three tax shelter products.

   c. Mark Weinberger, Vice Chair of Tax Services for Ernest &Young, said his firm's involvement with the mass marketing of tax shelters is "a thing of the past".

   d. Senator Carl Levin (D-Mich.) replied that "we cannot trust this industry to police itself."

2. The Internal Revenue Service announced in July, 2003 that Ernest & Young had agreed to pay the Internal Revenue Service $15,000,000 to settle an examination of that Firm's marketing of tax shelters.

3. In a speech at the annual conference of Financial Executives International, William McDonough, Chief of the Public Company Accounting Oversight Board, told the attendees that he had informed the heads of the Big Four accounting firms that "I'm not responsible for the continuing existence of any of the four firms." Now that's telling it like it is.

4. H&R Block agreed to pay more than $3,000,000 to resolve a dispute with 42 states over whether it properly advised customers that it charged a $22 fee for its optional "Peace of Mind" accuracy guarantee. This program guaranteed to pay up to $5,000 of additional income tax owed by a client due to a preparer's error. In 2001, it is alleged, H&R Block automatically charged the fee without getting the customers' consent!

5. The Justice Department indicted an H&R Block office manager and three others who used customers' personal information from returns prepared by H&R Block to obtain fraudulent credit cards and to divert tax refund

checks. There was no indication as to whether the "Peace of Mind" guarantee covers identity theft.

6. On November 20th, the Internal Revenue Service announced that it is auditing nine of the largest 15 nonprofit credit counseling organizations to determine whether they are abusing their exempt status by taking part in deceptive practices and offering services for excessive fees. The Internal Revenue Service will also more closely scrutinize the applications of such organizations for exempt status in the future.

7. Interestingly, the attack on shelters is not limited to the Federal Government's efforts. Numerous individual taxpayers have sued KPMG and Ernest & Young, claiming that the firms promised that their strategies were "bullet proof." The claims seek treble damages under RICO and punitive damages. At least two well known law firms have also been named in the lawsuits. 40 states have joined with the Internal Revenue Service in information sharing on abusive transactions.

8. Fittingly, the Internal Revenue Service has summoned client lists and similar information relating to tax shelters from several law firms.

III. EMPLOYMENT TAX MATTERS

A. 2003 Developments

1. As noted above, the Internal Revenue Service has targeted employment taxes for stepped up enforcement activities. Among the items which most concern the Service are misclassified workers; failure to issue Forms 1099; tax treatment of payments to or withdrawals by S corporation shareholders; and "off-the-book" payments.

2. In Emergency Medical Care Associates, the Tax Court granted §530 employment tax relief to a corporation which had misclassified emergency room doctors as independent contractors, even though the employer had failed to timely file Forms 1099-MISC and 1096 due to "confusion on the part of the taxpayer's accountant." The Court concluded that the delinquent filing did not violate the §530 requirement that all returns (including information returns) filed with respect to the workers be consistent with their status as independent contractors.

3. Statutory employees – i.e., officers of a corporation – are, by definition, employees for employment tax purposes. Therefore, withdrawals by the sole shareholder – employee of a professional corporation which the Tax Court determined to be compensatory were held to constitute wages for

FICA and FUTA purposes. The attorney-owner was not entitled to §530 relief, in part because no Form 1099-MISC had been filed. This case, Western Management, Inc., was also decided by the Tax Court.

4. In Charlotte's Office Boutique, the Tax Court ruled that the shareholder-employee could not avoid employment taxes by treating a portion of the withdrawals she took from the taxpayer as "royalties" paid for her transfer of "exclusive know-how" to the business. The Court agreed with the Internal Revenue Service that the payments really constituted wages for the shareholder-employee's substantial services.

5. In six separate decisions issued on the same day, the Tax Court held that amounts withdrawn from S corporations by their shareholder-employees represented payments for services; that corporate officers who perform more than minor services are employees; and that shareholder-officers of S corporations were not exempted from employee status simply because of the passthrough to shareholders of S corporation income. §530 relief was not available. In view of the Internal Revenue Service's attack on "understated" wages paid by S corporations to their shareholder-employees, practitioners should encourage clients to report "reasonable" amounts of S corporation withdrawals as wages.

6. The Internal Revenue Service is again planning to attempt to match K-1's from partnerships and S corporations to individual returns. As those of you whose clients previously received Internal Revenue Service Schedule K-1 matching notices know, the initial effort by Internal Revenue Service to do K-1 matching was, to be polite about it, "a disaster." The Internal Revenue Service has promised to do a better job this time.

7. The Treasury Inspector General for Tax Administration has criticized the Internal Revenue Service for failing to penalize employers filing Forms W-2 with incorrect names or Social Security numbers, despite numerous complaints from the Social Security Administration which, in many instances, provided the Internal Revenue Service with the correct information.

8. A recent Internal Revenue Service initiative is aimed at questionable Forms W-4 filed by taxpayers who are taking frivolous return reporting positions. The Internal Revenue Service will be asking employers to flag for the Internal Revenue Service Forms W-4 which raise certain warning signs.

IV. COLLECTION AND ENFORCEMENT MATTERS

A. 2003 Developments

1. In United States v. Craft, the Supreme Court ruled that federal tax liens attach to property held in a tenancy by the entireties, even though only one spouse is liable for the tax deficiency. This decision came as a great surprise to practitioners who have since been awaiting guidance from the Internal Revenue Service as to how Craft would be applied.

2. In Notice 2003-60, the Internal Revenue Service issued guidance on this issue. The principal aspects of the Notice are as follows:

   a. Craft is not new law. Therefore, the Internal Revenue Service can rely on Craft for tax liens which arose before the case was decided in 2002.

   b. The Internal Revenue Service will not apply Craft to the detriment of third parties who reasonably believed that state law precluded a tax lien from attaching to entireties property, but only where the property interest was created before the date of the Craft decision.

   c. The Internal Revenue Service is more apt to employ Craft to cash and cash equivalents, rather than to real or tangible personal property because of the practical difficulties in seizing and selling hard assets.

   d. The Internal Revenue Service will act with care in order to limit the likelihood of adverse consequences for the non-responsible spouse.

   e. In general, the value of the taxpayer's interest on the entireties property will be treated as 50%.

   f. If encumbered property is sold without discharging the tax lien, the lien will continue to apply to the one-half interest acquired by the transferee.

3. Notice 2003-60 also provides examples as to how the Internal Revenue Service expects to apply Craft in a variety of different situations. It is must reading for practitioners faced with collection efforts.

4. In Hatchett v. United States, the Sixth Circuit Court of Appeals held that the Craft decision applies retroactively to all cases still open.

5. In an important decision with bizarre facts, the District Court of Minnesota held in United States v. Munger that the Internal Revenue Service could foreclose tax liens against Jeffrey Munger on a duplex owned by Mr. Munger and his wife, Victoria, as joint tenants, obtain a decree of sale of the property, and apply one-half of the sale proceeds to Mr. Munger's tax liabilities. Munger owed taxes for 1992-1998, filed separate returns, and supported Victoria who alleged that she had a mental illness which prevented her both from working and from throwing things away. (No, I did not make this up; the City of Bloomington twice condemned the duplex for excessive accumulation of waste.) Victoria argued that a forced sale would prejudice her separate interest in the property, but the Court held that under the principles enunciated in the Supreme Court case of United States v. Rogers, a sale of a taxpayer's property can be ordered even if an innocent third party also has an interest in the property, provided the third party receives her share of the proceeds. It is interesting (although not particularly informative) to note that the Mungers were not living in the duplex at the time the case was heard (because of the condemnation) but that their 32-year old son and Victoria's mother were living there rent-free. (Munger was a candidate for this year's "unluckiest taxpayer in America" honors – see below)

6. In late 2002, Pennsylvania created a new compliance unit – the Pass Through Business Unit – to identify matters in which passthrough entities and their owners had not satisfied all of their tax obligations. Permit me a point of personal pique. This Unit is worse than useless; on a scale of one to 10, I'd give it a one, but only because there are no zeroes on that scale. Anyone working on a matter assigned to this Unit should be prepared to file a Protest with the Board of Appeals.

V. OTHER IMPORTANT 2003 DEVELOPMENTS

A. Old Friends

1. The battle over the treatment of contingent fees rages on with the courts more divided than ever. In Banks v. Commissioner, the Sixth Circuit held that a $150,000 contingent fee paid to counsel in an employment discrimination case was excludable from the income of the client-taxpayer. The District Court of Vermont reached a similar result in Raymond v. United States, a wrongful termination case. Because of the 2% floor on miscellaneous itemized deductions and the impact of the AMT, the exclusion of counsel fees from income produces a far better tax result than does the alternate inclusion-deduction regime.

a. The Fifth, Sixth and 11th Circuit Courts of Appeal have held that contingency fees are excludable; the Third, Fourth, Seventh, 10th and Federal Circuit Courts have ruled that the fees are taxable to the client. The Ninth Circuit has held that fees are includable for taxpayers living in California and Alaska but excludable for taxpayers residing in Oregon!

b. We continue to await Supreme Court resolution of this issue. (I know, I said that last year, too.)

2. The continuing effort of taxpayers to convert lottery winnings to capital gains "keeps on keepin' on." In Boehme, the Tax Court rejected capital gains treatment for a taxpayer who assigned her right to receive $1,250,000 over 25 years to a financial services company for a $400,000 lump sum, concluding that the right to receive future (ordinary income) lottery payments is not a capital asset. The Court reached the same result in the Simpson case.

3. An attorney, Mr. Alfaro, conducted his law practice as a sole proprietor. An Internal Revenue Service audit of his returns resulted in deficiencies attributable solely to the business. Alfaro paid the tax and interest and deducted the interest as a trade or business expense, notwithstanding Temporary Regulation §1.163-9T(b)(2)(i)(A) which disallows a deduction for interest paid on individual income tax liabilities as "personal" interest. The Tax Court sided with the Internal Revenue Service and was affirmed by the Fifth Circuit which upheld the validity of the Regulation. Five other Circuit Courts of Appeal have also decided this issue in favor of the Internal Revenue Service.

4. In IR-2002-135, issued last December, the Internal Revenue Service revised its voluntary disclosure policy with regard to criminal cases. Voluntary disclosure does not bind the Internal Revenue Service to forego a criminal referral decision, but it is a key factor in influencing the Service not to refer a case for prosecution. The revised policy focuses on when a voluntary disclosure is timely (e.g., before an examination has begun, notice of audit is sent, a tip is received regarding noncompliance, etc.) and on what kind of communication constitutes adequate voluntary disclosure.

5. §197 provides, generally, for 15-year amortization of intangible assets purchased in the acquisition of a business or an interest in a business. This rule applies to covenants not to compete. Can an acquisition of a business take the form of a stock redemption? Internal Revenue Service believes so, and the courts have agreed. Thus, in Frontier Chevrolet Co., the corporation redeemed the 75% interest of its founder, resulting in its general manager's becoming the sole shareholder. (He had owned 25% of

the stock before the redemption.) As part of the buyout, the redeeming shareholder entered into a five-year noncompete agreement. The Tax Court and Ninth Circuit held that the redemption was an indirect acquisition of a business interest, even though the corporation remained in the same business and did not acquire new assets. Thus, the covenant had to be amortized over 15 years. This case illustrates an important practice point.

6. Rev. Rul. 2003-28 deals with the deductibility as a charitable contribution of patents. The Ruling deals with a number of examples, some of which qualify and some of which don't. This Ruling should be referred to when advising clients considering the donation of patents which are subject to licensing or transfer restrictions.

7. The Internal Revenue Service did not extend into 2003 the waiver of taxes on the value of employee leave. Leave-based donation payments had been dealt with in Notice 2001-69 following the terrorist attacks of September 11, 2001. See Notice 2003-1.

8. Teachers are reminded that 2003 is the last year (barring an extender) in which they can claim an above-the-line deduction of up to $250 for out-of-pocket expenses incurred in purchasing books, supplies or equipment for their schools or classrooms. The 2002 Tax Act added this provision for the years 2002 and 2003 only. As a result, my wife plans to retire in June.

B. New Friends

1. In a very pro-taxpayer development, the Internal Revenue Service announced in CCA 200344008 that an S corporation could deduct in full the cost of personal flights on the corporation's airplane and that the resulting pass-through of the deduction to the S corporation shareholders was not limited to the amount of the airplane expense reported by the shareholders as compensation for their personal use, even though that latter amount was determined by using the Standard Industry Fare Level ("SIFL"). The SIFL produced a far lower compensation cost than the actual expense of the flight. The Announcement follows the result in Sutherland Lumber Southwest, an Eighth Circuit case involving a C corporation.

2. Under the Bankruptcy Code, an income tax liability can be discharged, provided the bankruptcy petition is filed more than three years after the date of the return to which the tax liability relates. Reine v. Internal Revenue Service makes clear that in applying this three-year period, the relevant date is the due date for filing the return, not the earlier actual filing date of the return.

3. In Mourad v. Commissioner, the sole shareholder of an S corporation which entered Chapter 11 bankruptcy argued that the bankruptcy filing either terminated the S corporation's status or created a separate taxable entity and, as such, that he was not liable for taxes resulting from the gain recognized by the corporation on its sale of an apartment complex. These arguments were (properly) rejected.

    a. Should the taxpayer have revoked the S election before the bankruptcy filing? Does that work? The law is not finally settled on this issue.

4. Two interesting developments involving trusts:

    a. In Scott v. United States, the Tax Court held that investment advice fees paid by a trust are not fully deductible but, rather, are subject to the 2% floor for miscellaneous itemized deductions.

    b. In Mattie K. Carter Trust v. United States, a testamentary trust held as one of its assets a 15,000 acre ranch on which cattle ranching and oil and gas operations were conducted. The trustee devoted a substantial amount of time to the ranch operation, as did a full-time manager under the trustee's supervision. The Internal Revenue Service treated the losses from the ranch's operations as passive activity losses of the trust, subject to the PAL limitations. In a case of first impression, the District Court held that the "participation" by the trust in ranch operations had to be measured by reference to the activities of the trustee and those other persons who work on the ranch. The Internal Revenue Service argued that only the trustee's activities were relevant but, even accepting this position, the Court found that the "material participation" test for an active business was met. This is a very important decision.

5. In Rev. Proc. 2003-16, the Internal Revenue Service listed new allowable grounds for the waiver of the 60-day rule for tax-free rollovers from qualified plans or IRA's. Waiver requests will be granted in circumstances such as error by the trustee, death, disability, hospitalization, incarceration and in other situations in which failure to waive the rule would "offend equity and good conscience." This Rev. Proc. is a major liberalization of past Internal Revenue Service practice.

6. Regulations were issued under §121 dealing with the home sale exclusion. The regulations are generally favorable to taxpayers. In particular, if a principal residence is used both for residential and business (e.g., home office) purposes, the entire gain from sale (and not just the gain attributable to the personal use portion) can be excluded, except for certain

gain attributable to depreciation recapture. To qualify for this special treatment, both the residential and nonresidential portions of the home must be within the same dwelling unit. In addition, the regulations permit the §121 exclusion to encompass vacant land adjacent to the land on which the house is located if the vacant land had been used as part of the principal residence.

7. The following 2003 developments regarding medical expenses should be of interest:

   a. In Rev. Rul. 2003-57, the Internal Revenue Service ruled that cosmetic surgery costs could be deducted as a medical expense, but only if the procedure is needed to correct a deformity relating to a congenital defect or personal injury and if it promotes proper body function or prevents or treats illness or disease. As such, breast reconstruction after a mastectomy is deductible, but breast augmentation for appearance purposes is not. Laser eye surgery costs would also be deductible; teeth-whitening procedures are not.

   b. In Rev. Rul. 2003-58, the Internal Revenue Service concluded that amounts paid for medicine or drugs are deductible only if available through prescription only. Over-the-counter medicines are not deductible, but the cost of medical equipment (e.g., crutches) is.

   c. Recall that the Internal Revenue Service recently ruled that obesity is a disease, so that weight loss programs for the obese are now deductible.

   d. Although the cost of non-prescription drugs is not deductible (see item "b" above), the Internal Revenue Service ruled in Rev. Rul. 2003-102 that flexible spending accounts could be used to reimburse employees for the cost of non-prescription drugs. Vitamins do not count. This is certain to be a popular change, because of the "use it or lose it" feature of FSA's.

8. The Military Family Tax Relief Act of 2003 provides enhanced benefits to service personnel, including a $12,000 tax-free death benefit, an elective suspension of the testing rule for the "two years out of five" ownership and use requirements for the $250,000 homesale exclusion, and above-the-line deductions for travel of 100 or more miles from home for National Guard and Reserve unit members.

9. Practitioners who wish to register for three new Internal Revenue Service Internet tools known as "e-services" can do so on the Internal Revenue Service website, www.irs.gov, at the "Tax Professionals Page." The e-

services are intended to enable practitioners to work electronically with the Internal Revenue Service.

10. A list of important Internal Revenue Service toll-free phone numbers as of December 2, 2002 is included at the end of the materials.

VI. A BRIEF LOOK FORWARD

A. <u>Some Changes for 2004</u>

1. Personal exemption increases from $3,050 to $3,100.

2. Standard deduction increases to $9,700 for married couples filing jointly, $4,850 for single taxpayers and $7,150 for heads of households.

3. The itemized deduction phaseout will begin with AGI above $142,700.

4. The transportation fringe benefit exclusion will be $100 per month for commuter vehicles and $195 per month for qualified parking.

5. The annual gift tax exclusion remains $11,000.

6. The personal exemption phaseout for joint return filers will begin at $214,050 (from $209,250 this year); the phaseout for single taxpayers begins at $142,700 (up from $139,500).

7. The Social Security wage base rises from $87,000 to $87,900, the smallest increase in many years. The FICA rate of 6.2% for OASDI and 1.45% for Medicare (combined 7.65%) remains the same. Thus, the increase in the maximum OASDI to be withheld or paid over is $55.80.

8. The limitation on deductible contributions to defined contribution plans will increase from $40,000 to $41,000. The §415 compensation limit increases from $200,000 to $205,000.

9. The maximum elective salary reduction contribution amount for §401(k) plans increases from $12,000 to $13,000. The catch-up contribution maximum for participants aged 50 or over is increased from $2,000 to $3,000.

10. The standard mileage rate for use of a car increases from 36 cents per mile to 37.5 cents.

11. The addresses at which certain 2003 tax returns must be filed have changed. (PA, NJ, MD, and DC taxpayers will continue to file in Philadelphia if no payment is included with the return and in Cincinnati if a payment is included.)

12. The purchase of a 2004 Toyota Prius will give rise to a $2,000 clean-burning fuel vehicle deduction if placed in service before January 1, 2004. After December 31, 2003, the deduction will be reduced to $1,500. Apparently, clean air will be less valuable next year!

13. The Internal Revenue Service has begun charging a $150 user fee for the processing of an offer in compromise, unless the offer is based on doubt as to liability or a poverty level income guideline test is met. Merry Christmas from your Government!

VII. THE UNLUCKIEST TAXPAYER IN AMERICA

A. <u>2003 Candidates</u>

1. The following persons are worthy candidates for my annual "unluckiest taxpayer in America" award.

2. Larry Lartz was asked by friends to serve as president of the Dutch Club of York (PA), a nonprofit social club with "an aging membership body." This was an unpaid position. Lartz's youth was thought to help serve as a magnet to attract younger members. The Club, which employed several full-time staff people, had severe financial problems, and trust fund taxes went unpaid. When Lartz learned of this, he ordered that taxes be paid. The Club subsequently went bankrupt. Lartz, too, filed for personal bankruptcy because of his own financial difficulties. The Internal Revenue Service sought responsible person penalties from Lartz in his bankruptcy proceedings! Fortunately, the Court held that he was merely "in the wrong place at the wrong time." No good deed goes unpunished.

3. ImClone Systems, Inc. owes the Internal Revenue Service $41 million for failure to withhold on stock options exercised by management in 2002. As a result of the failure to withhold, Robert Goldhammer, the Chairman, resigned as did Harlan Waksol, the chief executive who had succeeded his brother, Samuel Waksol. Sam is now a guest of the United States at the Federal Penitentiary at Eglin Air Force Base for other reasons.

4. In <u>Capital Video Corp.</u>, the sole shareholder of the taxpayer began paying "tribute" to a purported mob boss for protection. Naturally, the payments were in cash and, naturally, the shareholder did not report the withdrawals from the corporation as income. The shareholder pled guilty to conspiracy to evade in 1997. During 1995 and 1996, the corporation paid the

shareholder's legal bills ($700,000) and deducted them. Naturally, the shareholder did not report these amounts as income. Naturally, the Internal Revenue Service disallowed the corporate deduction for the shareholder's legal fees. IRS won.

5. Eugene Amos, Jr. was a television cameraman working a January, 1997 game between the Chicago Bulls and Minnesota Timberwolves. He was operating a handheld camera on the baseline. Dennis Rodman chased a loose ball and landed on a group of photographers, including the unfortunate Mr. Amos. An annoyed Rodman then kicked Amos in the groin, resulting in (believe it or not) neck pain. Amos filed a police report but a few days later, Rodman agreed to pay Amos $200,000. Amos agreed to keep the terms confidential, not to assist in the criminal prosecution, and not to defame Rodman. Amos excluded the $200,000 from income as a physical personal injury; the Internal Revenue Service argued it was all taxable except for $1.00 because Amos did not produce evidence of the extent of his injuries! The Tax Court allowed $120,000 to be excluded, noting that the settlement included the confidentiality agreement and pledge not to assist in the prosecution.

6. In <u>Gerard v. Commissioner</u>, Bill Maritz, the CEO of Maritz, Inc., retaliated against his in-laws by terminating their employment with the Company. They sued Maritz, Inc., claiming (in the mother-in-law's case) acute emotional distress resulting in dramatic personality changes. She got $500,000; the father-in-law got $250,000. The Tax Court decided how much of the payments could be excluded from income (the case arose before the 1996 law change requiring a physical personal injury). Thanksgiving and Christmas at the Maritz house must be lots of fun.

7. An Illinois Circuit Court ruled that Sammy Sosa could not claim a tax credit for taxes paid to other states in which the Cubs played ball games. Illinois law requires a taxpayer whose employer is also based in Illinois to include <u>all</u> of his income as compensation paid in Illinois. Another strikeout for Sosa.

8. But this year's "winner" is William Esry, former chairman and CEO of Sprint Corporation. In 1999, WorldCom sought to take over Sprint. Sprint's shares traded as high as $75.50. Esry exercised a boatload of nonqualified options but didn't pay tax on exercise as a result of a tax shelter sold to him by Sprint's auditors, Ernst & Young. (The shelter involved the purported transfer of the options to a family limited partnership for a 30-year note; this is now on the Internal Revenue Service's listed transactions shelter list.) Esry sold none of the option shares. The takeover was scuttled by European antitrust regulators, and the price of Sprint's stock has plummeted. The Internal Revenue Service

assessed a tax on the gain from the option exercise. The tax, interest and penalties are greater than the value of the shares today! Moreover, according to The Wall Street Journal, Esry claimed 700,000 exemptions from withholding on his W-4, so he paid in virtually nothing from withholding. The Board of Directors of Sprint fired Esry when they learned of the shelter investigation, the Internal Revenue Service bill will wipe him out, and he apparently now has cancer to boot. He also has one hell of a lawsuit against Ernst & Young and the honor of winning my 2003 unluckiest taxpayer in America prize.

Happy Holidays to you and yours.