

# Federal Taxation<sup>†</sup>

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## I. INTRODUCTION

During 2002 federal courts in the United States decided nineteen cases that directly impact federal tax law in the Eleventh Circuit.<sup>1</sup> These cases involve a variety of tax law matters including Federal Insurance Contributions Act (“FICA”) payroll tax,<sup>2</sup> estate and gift tax,<sup>3</sup> IRS

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1. The cases included in this Survey are limited to tax cases decided (or orders issued) during 2002 by the federal district courts in the Eleventh Circuit, the United States Court of Appeals for the Eleventh Circuit, and the Supreme Court of the United States. See *United States v. Craft*, 535 U.S. 274 (2002); *United States v. Fior D'Italia*, 536 U.S. 238 (2002); *Young v. United States*, 535 U.S. 43 (2002); *Coggins Auto. Corp. v. Comm’r*, 292 F.3d 1326 (11th Cir. 2002); *Comyns v. United States*, 287 F.3d 1034 (11th Cir. 2002); *Estate of Atkinson v. Comm’r*, 309 F.3d 1290 (11th Cir. 2002); *McDonald v. S. Farm Bureau Life Ins. Co.*, 291 F.3d 718 (11th Cir. 2002); *Shepherd v. Comm’r*, 283 F.3d 1258 (11th Cir. 2002); *Thosteson v. United States*, 304 F.3d 1312 (11th Cir. 2002); *Wilkes v. United States*, 289 F.3d 684 (11th Cir. 2002); *Crutcher v. United States*, No. CV99-S-3286-NE, 2002 U.S. Dist. LEXIS 3994 (N.D. Ala. Feb. 15, 2002); *Estate of O’Neal v. United States*, 228 F. Supp. 2d 1290 (N.D. Ala. 2002); *Friedman v. United States*, No. 1:02-CV-2461-BBM, 2002 U.S. Dist. LEXIS 23496 (N.D. Ga. Sept. 24, 2002); *Hovind v. Schneider*, No. 3:02CV297/RV/MCR, 2002 U.S. Dist. LEXIS 22918 (N.D. Fla. Oct. 31, 2002); *In re McDermott*, No. 3:01-CV-1387-J-20, 2002 U.S. Dist. LEXIS 20228 (M.D. Fla. Sept. 10, 2002); *Nat’l Fed’n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300 (S.D. Ala. 2002); *Perlman v. United States*, No. 00-3703-CIV-GOLD-SIMONTON, 2002 U.S. Dist. LEXIS 7775 (S.D. Fla. Mar. 5, 2002); *Sillavan v. United States*, No. CV-01-BU-803-S, 2002 U.S. Dist. LEXIS 2127 (N.D. Ala. Jan. 11, 2002); *United States v. Ratfield*, No. 01-8816-CIV-FERGUSON, 2002 U.S. Dist. LEXIS 21450 (S.D. Fla. Sept. 29, 2002).

2. I.R.C. §§ 3101-3128 (2000). See *Fior D’Italia*, 536 U.S. 238; *McDonald*, 291 F.3d 718; *Thosteson*, 304 F.3d 1312; *Crutcher*, 2002 U.S. Dist. LEXIS 3994; *Perlman*, 2002 U.S. Dist. LEXIS 7775; *Sillavan*, 2002 U.S. Dist. Lexis 2127.

3. See *Estate of Atkinson*, 309 F.3d 1290; *Shepherd*, 283 F.3d 1258; *Estate of O’Neal*, 228 F. Supp. 2d 1290.

authority to levy and assess tax,<sup>4</sup> and discharges in bankruptcy.<sup>5</sup> Other tax-related matters addressed by courts in 2002 that impact tax law in the Eleventh Circuit include inventory recapture in an S-corporation conversion,<sup>6</sup> attorney fees for the prevailing party in a tax dispute,<sup>7</sup> and injunctions against tax preparers.<sup>8</sup> By far the most important tax case decided in the Eleventh Circuit was an Alabama district court case concerning the constitutionality of the new public disclosure requirements for tax-exempt political organizations.<sup>9</sup> Of the nineteen tax cases from 2002, the government prevailed in fourteen,<sup>10</sup> the taxpayer prevailed in three,<sup>11</sup> one case was a split decision,<sup>12</sup> and one case did not involve suit against the government.<sup>13</sup> This Article will examine each of these cases by category, pausing along the way to make observations about trends and themes to the extent they appear.

## II. FICA PAYROLL TAX

The FICA payroll tax cases from 2002 include one Supreme Court case, *United States v. Fior D'Italia*,<sup>14</sup> two appellate court cases, *McDonald v. Southern Farm Bureau Life Insurance Co.*<sup>15</sup> and *Thosteson v. United States*,<sup>16</sup> and two district court cases, *Crutcher v. United States*<sup>17</sup> and *Perlman v. United States*.<sup>18</sup> FICA payroll tax was by far

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4. See *Craft*, 535 U.S. 274; *Comyns*, 287 F.3d 1034; *Friedman*, 2002 U.S. Dist. LEXIS 23496; *Hovind*, 2002 U.S. Dist. LEXIS 22918; *Sillavan*, 2002 U.S. Dist. Lexis 2127.

5. See *Young*, 535 U.S. 43; *In re McDermott*, 2002 U.S. Dist. LEXIS 20228.

6. See *Coggins*, 292 F.3d 1326.

7. See *Wilkes*, 289 F.3d 684.

8. See *Ratfield*, 2002 U.S. Dist. LEXIS 21450.

9. *Nat'l Fed'n of Republican Assemblies*, 218 F. Supp. 2d 1300.

10. See *Craft*, 535 U.S. 274; *Fior D'Italia*, 536 U.S. 238; *Young*, 535 U.S. 43; *Comyns*, 287 F.3d 1034; *Estate of Atkinson*, 309 F.3d 1290; *Shepherd*, 283 F.3d 1258; *Thosteson*, 304 F.3d 1312; *Crutcher*, 2002 U.S. Dist. LEXIS 3994; *Friedman*, 2002 U.S. Dist. LEXIS 23496; *Hovind*, 2002 U.S. Dist. LEXIS 22918; *In re McDermott*, 2002 U.S. Dist. LEXIS 20228; *Perlman*, 2002 U.S. Dist. LEXIS 7775; *Sillavan*, 2002 U.S. Dist. Lexis 2127; *Ratfield*, 2002 U.S. Dist. LEXIS 21450.

11. See *Coggins*, 292 F.3d 1326; *Wilkes*, 289 F.3d 684; *Estate of O'Neal*, 228 F. Supp. 2d 1290.

12. See *Nat'l Fed'n of Republican Assemblies*, 218 F. Supp. 2d at 1354-55 (holding that the challenged statute, § 527(j), is in part constitutional and in part unconstitutional).

13. See *McDonald*, 291 F.3d 718 (involving suit by an employee against his employer for failure to pay FICA withholding taxes).

14. 536 U.S. 238 (2002).

15. 291 F.3d 718 (11th Cir. 2002).

16. 304 F.3d 1312 (11th Cir. 2002).

17. No. CV99-S-3286-NE, 2002 U.S. Dist. LEXIS 3994 (N.D. Ala. Feb. 15, 2002).

18. No. 00-3703-CIV-GOLD-SIMONTON, 2002 U.S. Dist. LEXIS 7775 (S.D. Fla. Mar. 5, 2002).

the most frequently litigated tax issue in 2002. This frequent litigation is likely due to the circumstances under which FICA tax liability arises for employers and other “responsible” persons. As many of the 2002 tax cases indicate, the employee pays one-half of the tax to the employer, the employer holds these funds in trust for the government, and the employer eventually pays the government both the employee-paid funds and an additional amount equal to the employee-paid amount. Because of the trust aspects of the FICA tax payment scheme, the typical risks associated with a mostly voluntary compliance tax system, and various aspects of responsible person status, it is not at all surprising that FICA taxes appear to be the most frequently litigated category of tax.

*A. IRS May Use Aggregate Estimates to Determine Employer’s FICA Tax Obligation*

In *Fior D’Italia* the Supreme Court addressed the long-unresolved matter of the scope of IRS authority to estimate an employer’s FICA tax liability.<sup>19</sup> In *Fior D’Italia* the IRS conducted a compliance audit of a restaurant after discovering a difference between the amount of tips reported by the restaurant as FICA wages and tips actually shown on credit card slips. As a result of its audit, the IRS issued an assessment, based on an aggregate estimate of unreported tips, against the restaurant for additional FICA taxes. Pursuant to the aggregate estimate, the IRS examined the taxpayer’s credit card slips to determine the average percentage paid as credit card tips, multiplied this average percentage by total restaurant receipts to come up with an estimate of total tips, and subtracted tips reported by the restaurant to come up with an estimate of unreported tips. The IRS applied the FICA tax rate to this unreported tip amount. The restaurant paid a portion of the assessment and filed a refund suit in district court. The IRS counterclaimed for the unpaid portion of the assessment.<sup>20</sup>

The issue in *Fior D’Italia* was whether the IRS is authorized to base FICA tax assessments on aggregate estimates of tips received by *all* employees, or whether the IRS must first determine tip income for *each* employee and use that information to calculate the employer’s FICA tax liability.<sup>21</sup> The district court and the Ninth Circuit ruled in favor of the taxpayer restaurant, concluding that the IRS is not legally authorized to use aggregate estimates, at least not without first adopting appropriate regulations.<sup>22</sup> Because the Ninth Circuit’s decision created a split

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19. 536 U.S. at 243.

20. *Id.* at 241-42.

21. *Id.* at 244.

22. *Id.* at 242.

among the circuits,<sup>23</sup> the Supreme Court granted the government's petition for certiorari.<sup>24</sup> The Supreme Court concluded that the IRS is authorized to use aggregate estimates.<sup>25</sup> The Court explained that IRS estimation authority stems from § 6201(a),<sup>26</sup> which authorizes the IRS "to make . . . assessments" of unpaid taxes.<sup>27</sup> This "assessment" authority, the Court explained, includes the "power to decide *how* to make . . . assessment[s]."<sup>28</sup> Courts have routinely held that reasonable estimates of tax liability are an appropriate means of assessment.<sup>29</sup> Thus, concluded the Court, the aggregate estimate is permissible so long as a reasonable method of calculation is employed.<sup>30</sup>

The restaurant argued that because FICA tax is calculated based on "wages" paid, which are defined as including tips received "by *an employee*," the employer's FICA tax liability should be based on each individual employee's wage, as opposed to an aggregate of all employee wages.<sup>31</sup> The Court rejected this argument, stating that the reference to the singular "employee" is contained in the definition section of the statute, not the operational section.<sup>32</sup> The statute that actually imposes the tax is the operational section, and it speaks in the plural referring to wages of employees.<sup>33</sup>

The Supreme Court also rejected the Ninth Circuit's contention that other tax statutes negatively imply that the IRS lacks authority to estimate income for purposes of determining FICA tax liability in the absence of specific statutory or regulatory authority.<sup>34</sup> For example, when a taxpayer does not use an appropriate method of accounting to calculate taxable income, one tax statute authorizes the IRS to use a method of accounting that, "in the opinion of the Secretary, . . . clearly reflect[s] income."<sup>35</sup> Additionally, another tax statute permits the IRS to make "proper adjustments . . . without interest" to the reported

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23. See *Fior D'Italia, Inc. v. United States*, 242 F.3d 844, 850-51 (9th Cir. 2001); *330 West Hubbard Rest. Corp. v. United States*, 203 F.3d 990, 997 (7th Cir. 2000); *Bubble Room, Inc. v. United States*, 159 F.3d 553, 568 (D.C. Cir. 1998); *Morrison Rest., Inc. v. United States*, 118 F.3d 1526, 1530 (11th Cir. 1997).

24. 536 U.S. at 242.

25. *Id.*

26. I.R.C. § 6201(a) (2000).

27. 536 U.S. at 243 (quoting I.R.C. § 6201(a)).

28. *Id.*

29. *Id.*

30. *Id.* at 251.

31. *Id.* at 244.

32. *Id.*

33. *Id.* at 244-45.

34. *Id.* at 245 (referencing I.R.C. §§ 446(b), 6205(a)(1)).

35. *Id.* (quoting I.R.C. § 446(b)).

amount of FICA taxes when an employer underpays those taxes.<sup>36</sup> The Supreme Court concluded in *Fior D'Italia* that these statutes only apply to small aspects of tax law and say absolutely nothing about particular methods of calculation.<sup>37</sup>

The Supreme Court also rejected the taxpayer's contention that several features of aggregate estimates make it "unreasonable" for the IRS to use this method.<sup>38</sup> The taxpayer claimed that aggregate estimates sometimes include tips that should not count for purposes of calculating the employer's FICA tax liability<sup>39</sup> and that using credit card slips can overstate tips.<sup>40</sup> The Supreme Court rejected these over-inclusive arguments because the taxpayer had already stipulated that it did not challenge the accuracy of the IRS estimate of tips in this case.<sup>41</sup> Thus, while the Supreme Court recognized the possibility that this argument could indicate that an aggregate estimate is unreasonable in a particular case, the taxpayer restaurant in this case could not make such a claim.<sup>42</sup>

Justice Souter's dissent in *Fior D'Italia* is very persuasive. Indeed, Justice Souter argued that the government's FICA tax assessment authority should not exceed what the taxpayer restaurant was required to report initially as wages for FICA tax purposes.<sup>43</sup>

#### *B. Employees Do Not Have a Private Right of Action Against Employers for Failing to Collect FICA Taxes*

In *McDonald* the Eleventh Circuit rejected an insurance agent's attempt to sue his employer for failure to pay one-half of the FICA tax imposed on the insurance agent's wages.<sup>44</sup> The employer sought to

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36. *Id.* at 246 (quoting I.R.C. § 6205(a)(1)). The regulations indicate that I.R.C. § 6205(a)(1) refers to an employer's "adjustments" made before the IRS assesses an underpayment. Treas. Reg. § 31.6205-1 (2000).

37. 536 U.S. at 245-46.

38. *Id.* at 246-47.

39. For example, tips less than \$20 in a month from an employee and tips that cause an employee's wages to exceed certain ceiling amounts are not counted as wages of an employee. *Id.* at 246.

40. *Id.* at 247. This is because cash customers tend to tip less than credit card customers, some customers get cash back from credit card tips, and some restaurants deduct the credit card company fee from credit card tips. *Id.*

41. *Id.*

42. *Id.* at 247-48.

43. *Id.* at 253 (Souter, J., dissenting).

44. 291 F.3d at 721. Under FICA, a tax is imposed on employers and workers based on wages paid to workers. I.R.C. § 3101. If the worker is an employee, the worker pays one-half of the FICA tax (through withholding) and the employer pays the other half (through payroll taxes). *Id.* If the worker is an independent contractor or otherwise

dismiss the suit, arguing that no private right of action exists under FICA.<sup>45</sup> The Eleventh Circuit agreed, concluding that Congress did not intend to allow a private right of action by an employee against his employer for failure to comply with FICA.<sup>46</sup> The Court explained that FICA was not enacted for the benefit of employees.<sup>47</sup> Instead, FICA is simply “a tax-assessing statute designed to raise revenue for the federal government.”<sup>48</sup> Additionally, although FICA and the Social Security Act<sup>49</sup> (“SSA”) are linked in that the money raised through the FICA tax must be used exclusively to fund Social Security, the purposes of the two statutes are different.<sup>50</sup> The court reasoned that “FICA assesses a tax on employers and employees in order to fund a government program.”<sup>51</sup> Conversely, “the SSA . . . provides funds for disabled and retired employees.”<sup>52</sup> Thus, a qualifying employee receives SSA benefits even if his employer has not complied with FICA.<sup>53</sup> Therefore, an employee does not need to sue his employer to collect SSA benefits because their availability does not depend on the employer’s FICA compliance.

*C. “Responsible Persons” Can Be Held Liable for Payment of FICA Taxes Even if Another Person is Also Liable*

The next group of FICA cases involved “responsible” persons, such as officers and shareholders of an employer, who were held liable for FICA taxes that were not paid by the employer as the primary obligor. When a company fails to pay FICA taxes withheld from employee wages, § 6672(a) imposes a penalty equal to the total amount of the unpaid tax on a “responsible person,” who is “[a]ny person required to collect, truthfully account for, and pay over” the tax.<sup>54</sup> A responsible person can include any person who, based on her status in the business, has the

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self-employed, the worker pays both the employee’s portion of the tax and the employer’s portion. *Id.* The employer does not have to pay any FICA excise tax for these workers. *Id.*

Because defendant employer classified taxpayer as an independent contractor, it did not pay any excise taxes. 291 F.3d at 721. Instead, taxpayer paid one hundred percent of his FICA tax. *Id.*

45. 291 F.3d at 722.

46. *Id.* at 726.

47. *Id.* at 723.

48. *Id.*

49. 42 U.S.C. §§ 301-1399jj (2000).

50. 291 F.3d at 723-24.

51. *Id.* at 724.

52. *Id.*

53. *Id.*

54. I.R.C. § 6672(a).

actual authority or ability to pay the tax.<sup>55</sup> Thus, factors to consider when deciding if a person is a responsible person include whether the person holds corporate office, controls financial matters, has authority to disburse corporate funds, owns stock in the company, or has authority to hire and fire employees.<sup>56</sup> Once an individual is established as a responsible person, she then has the burden of proving that her failure to pay FICA taxes was not willful.<sup>57</sup> The willfulness requirement is satisfied if the responsible person knows of payments to other creditors after becoming aware of the failure to pay the taxes.<sup>58</sup> The following three responsible person FICA cases demonstrate that it is nearly impossible for officers and shareholders to avoid liability for unpaid FICA taxes, even when another person is primarily liable for the tax.

In *Thosteson* the Eleventh Circuit concluded that a taxpayer who was an officer, employee, and shareholder of his employer could not avoid liability as a responsible person by claiming that another person was primarily responsible for the payment of the withheld taxes.<sup>59</sup> After the jury returned a verdict in favor of the taxpayer employee, the trial judge granted the government's motion for judgment notwithstanding the jury's verdict.<sup>60</sup> The Eleventh Circuit rejected the taxpayer's assertions that he could not be held liable as a responsible person because another person—the majority shareholder—was primarily

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55. *Id.*

56. *Thosteson*, 304 F.3d at 1318.

57. *Id.* at 1317.

58. *Id.* at 1318.

59. *Id.* Taxpayer in *Thosteson* was an incorporator and vice-president for his employer. Taxpayer's responsibilities included sales, "growing" the business, hiring and firing employees, determining financial policy, setting salaries, paying employees, entering loan agreements, signing tax returns, opening bank accounts, and serving as signatory on bank accounts for up to a specified maximum amount. While taxpayer wrote checks for more than the specified maximum, none of these above-the-maximum checks was dishonored, and at least one was honored. Taxpayer also signed some of his employer's withholding tax returns. Taxpayer was also a minority shareholder of his employer and eventually became president. Taxpayer knew that his employer had failed to pay its taxes. Nevertheless, taxpayer continued to write checks to other creditors. Taxpayer emphasized the role of the former sole shareholder, who had also been sued by the government but disappeared. Taxpayer claimed that this former sole shareholder was not only the sole stockholder for a while, but he and his wife also controlled all major decisions within the business. Taxpayer further claimed that he was hospitalized when he found out the taxes had not been paid. After finding out about the tax liability, taxpayer claimed that he used his best efforts to establish a repayment plan by arranging for his employer to make weekly payments of \$30,000 to the IRS. However, after making only three such payments, taxpayer claimed that his efforts were frustrated by the former sole shareholder, who stopped the tax restitution payments. *Id.* at 1315.

60. *Id.* at 1314.

responsible for the payment of the withheld FICA taxes.<sup>61</sup> The Eleventh Circuit explained that a company can have more than one responsible person.<sup>62</sup> Additionally, the taxpayer's claims that the majority shareholder interfered with the taxpayer's attempted payment of the back taxes did not negate the taxpayer's willfulness so as to excuse the failure to pay.<sup>63</sup>

In *Crutcher* the district court also concluded that a responsible person is not relieved of liability because another person is primarily responsible for the tax, even if the taxpayer does not actually know that the tax is unpaid.<sup>64</sup> The taxpayer in *Crutcher* was a minority stockholder, officer, director, and employee of a corporation that failed to pay its FICA tax. The taxpayer alleged that his brother, the president and majority stockholder in the company, was in control of the company and its in-house accounting staff. Although taxpayer secured contracts for the company and had check-writing authority, he would only sign checks when his brother was unavailable. Even then, the taxpayer often would not know who the payees of these checks were because his brother had authorized the checks. In fact, the taxpayer never authorized accounting employees to prepare checks for the payment of creditors. For example, when the company experienced cash flow problems, which left it unable to cover expenses or secure bank loans, taxpayer learned of this predicament along with other employees when his brother distributed a memorandum.<sup>65</sup> Also, taxpayer's brother, not taxpayer, signed and filed the company's tax returns.<sup>66</sup> Despite his brother having superior knowledge of the tax delinquency, the court concluded that the taxpayer could not escape liability as a responsible person by claiming that his brother had ultimate control over tax payment matters.<sup>67</sup> Instead, the court noted that the taxpayer's failure to take steps to ensure payment of withholding taxes is "reckless disregard of a known or obvious risk" that withheld taxes may not be paid.<sup>68</sup>

Finally, in *Perlman*, the district court concluded that a taxpayer can be presumed liable as a responsible person based solely on his status

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61. *Id.* at 1318.

62. *Id.*

63. *Id.* at 1319.

64. 2002 U.S. Dist. LEXIS 3994, at \*25-28.

65. *Id.* at \*6-10. On January 5, 1997, taxpayer's brother notified taxpayer and others within the company that "cash flow problems . . . resulted in unpaid withholding taxes" and that "the company ha[d] approached the IRS to work out a payment arrangement." *Id.* at \*10.

66. *Id.* at \*12.

67. *Id.* at \*27-28.

68. *Id.* at \*34.

with the company.<sup>69</sup> The taxpayer in *Perlman* was a majority shareholder and director who guaranteed loans for the company, had the authority to hire and fire and to authorize payment of bills, and determined financial policy. The taxpayer knew that the company's payroll taxes were delinquent. During the time the company was not paying its payroll taxes, it was paying its debts to other creditors. The taxpayer failed to present evidence in support of his claim that he was not liable for the taxes because he lacked authority over the company's affairs and had no knowledge of its failure to pay the taxes.<sup>70</sup> Nevertheless, the Eleventh Circuit explained in *Harris v. United States*<sup>71</sup> that "liability attaches to any person who, based on her status in the corporation, has 'actual authority or ability' to pay the taxes."<sup>72</sup> The government established that the taxpayer was a responsible person because of his authority to sign checks, to hire and fire employees, manage the company, determine financial policy, and pay bills.<sup>73</sup> In addition, the taxpayer owned a majority of the corporation's stock and was a member of the corporation's board.<sup>74</sup> Although taxpayer did not exercise all of this authority regularly, the court concluded that it was the existence of the authority that created a presumption of liability not whether the authority was exercised.<sup>75</sup> Because the presumption was not rebutted and the taxpayer acquiesced in the company's payment to other creditors while the taxes remained unpaid, the taxpayer was held liable for the FICA tax as a responsible person.<sup>76</sup>

### III. ESTATE AND GIFT TAX

The estate and gift tax cases from 2002 include two appellate court cases, *Estate of Atkinson v. Commissioner*<sup>77</sup> and *Shepherd v. Commissioner*,<sup>78</sup> and one district court case, *Estate of O'Neal v. United States*.<sup>79</sup> *Estate of Atkinson* concerned an estate's eligibility for a

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69. 2002 U.S. Dist. LEXIS 775, at \*15.

70. *Id.* at \*16-17.

71. 175 F.3d 1318 (11th Cir. 1999).

72. *Id.* at 1321.

73. 2002 U.S. Dist. LEXIS 7775, at \*16-17.

74. *Id.* at \*17.

75. *Id.*

76. *Id.* at \*18.

77. 309 F.3d 1290 (11th Cir. 2002).

78. 283 F.3d 1258 (11th Cir. 2002).

79. 228 F. Supp. 2d 1290 (N.D. Ala. 2002).

charitable estate tax deduction.<sup>80</sup> *Shepherd* and *Estate of O'Neal* concerned estate and gift tax valuation issues.<sup>81</sup>

A. *Estate Tax Charitable Deduction Denied For Trust Not Operated in Strict Compliance with CRAT Rules*

In *Estate of Atkinson* the court emphasized the importance of a trust operating in compliance with statutory requirements if the trust purports to be a charitable remainder annuity trust.<sup>82</sup> Section 2001 imposes a federal estate tax on “the transfer of the taxable estate of every decedent.”<sup>83</sup> In computing the amount of the “taxable estate,” a deduction is generally allowed for the portion of the estate directly devised to charity.<sup>84</sup> When a decedent donates a remainder interest in property to charity, the deductible interest must pass to the charity in the context of a “charitable remainder annuity trust” (“CRAT”), a “charitable remainder unitrust,” or a “pooled income fund.”<sup>85</sup>

In *Estate of Atkinson* the decedent intended to create a CRAT.<sup>86</sup> By statute, a CRAT requires that certain minimum amounts be paid annually to noncharitable beneficiaries for specified periods before the remainder is paid to charity.<sup>87</sup> The CRAT is required to pay the noncharitable annuity from the first year of its existence.<sup>88</sup> However, in *Estate of Atkinson*, one of the noncharities did not receive annuity payments as called for in the trust documents.<sup>89</sup> Because the trust “did not adhere to the CRAT [rules] throughout its existence,” the Eleventh Circuit held that the charitable remainder interest did not qualify the estate for a charitable deduction.<sup>90</sup> The court rejected the estate’s argument that because no interest ever passed to both noncharitable beneficiaries and to charity, the CRAT rules did not apply.<sup>91</sup> The court

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80. 309 F.3d at 1291-92.

81. 283 F.3d at 1259-60; 228 F. Supp. 2d at 1292.

82. 309 F.3d at 1293.

83. I.R.C. § 2001(a) (2000).

84. *See id.* § 2055(a)(2).

85. *See id.* § 2055(e)(2)(A).

86. 309 F.3d at 1293. Decedent created a trust that provided that decedent receive a lifetime annuity and that, at her death, the annuity would be divided between four other beneficiaries for their lifetimes, provided that those beneficiaries agreed to pay their share of any estate taxes due at decedent’s death. After the death of the last beneficiary, any amount remaining in the trust would be donated to charity. *Id.*

87. I.R.C. § 664(d)(1).

88. *See* Treas. Reg. §§ 1.664-1(a)(4) and 1.664-2(a)(5) (2000).

89. 309 F.3d at 1292. The Tax Court determined that no annuity payments were ever actually made to decedent during her life from the assets of the trust. *Id.*

90. *Id.* at 1296.

91. *Id.*

explained that for purposes of the estate tax charitable deduction, property interests transferred inter vivos are considered to pass immediately from the decedent to the recipient.<sup>92</sup>

#### B. Valuation For EG&T Purposes

In 2002 two federal courts addressed issues related to valuation. The first valuation case, *Shepherd v. Commissioner*,<sup>93</sup> involved the issue of whether gifts of land should be valued for gift tax purposes as gifts of land or whether they should be valued as gifts of minority partnership interests.<sup>94</sup> If valued as gifts of minority partnership interests, the valuation takes into account minority and marketability discounts attributable to the gift recipients' minority status in the partnership.<sup>95</sup> However, if valued as gifts of land, the valuation does not consider these discounts.<sup>96</sup> The second valuation case, *Estate of O'Neal v. United States*,<sup>97</sup> concerned the valuation of claims against a decedent's estate when the value of the claim stems from pending tax court litigation.<sup>98</sup>

In *Shepherd* the taxpayer executed a partnership agreement creating a partnership between the taxpayer and his sons. The sons owned minority interests in the partnership. On the same day that he executed the partnership agreement, the taxpayer deeded land to the partnership. However, at the time the father deeded the land to the partnership, the partnership had not yet been formed because the sons did not execute the partnership agreement until the next day. On his gift tax return, the taxpayer reported the transfer as gifts of land to his sons and valued them accordingly. In response to a notice of deficiency, however, the taxpayer argued that these gifts were overvalued on his return. Instead, taxpayer contended that the gifts were of partnership interests, which should be valued taking into account minority and marketability discounts.<sup>99</sup>

The Eleventh Circuit concluded that the gifts were of land, not of partnership interests.<sup>100</sup> The court explained that the taxpayer not only reported the gifts as gifts of land on his gift tax return, but also referred to the gifts as undivided interests in land in his initial petition

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92. *Id.* at 1295; *see also* Treas. Reg. § 20.2056(c)-1(a)(5).

93. 283 F.3d 1258 (11th Cir. 2002).

94. *Id.* at 1260.

95. *Shepherd v. Comm'r*, 115 T.C. 376, 383-84 (2000).

96. 283 F.3d at 1262-63.

97. 228 F. Supp. 2d 1290 (N.D. Ala. 2002).

98. *Id.* at 1292.

99. 283 F.3d at 1260-61.

100. *Id.* at 1260.

for review in the tax court.<sup>101</sup> Additionally, because the partnership necessarily must have been created before the deed became effective (one cannot give land to a nonexistent partnership), the taxpayer's sons obtained their interests in the leased land only "by virtue of their status as partners in the partnership."<sup>102</sup> Thus, the court concluded that the taxpayer "created a partnership in which his sons held established shares and then gave the partnership," and hence the minority partners as individuals, taxable gifts of land.<sup>103</sup>

In *Estate of O'Neal* decedent's estate sought a refund of estate taxes paid based on claims against the estate that were pending in tax court at decedent's death.<sup>104</sup> The claims stemmed from transferee taxes owed by the estate as a result of gifts decedent made prior to death. In the transferee tax case, the tax court concluded that the gift recipients were liable for the gift tax, leaving only the valuation issue unresolved. Both parties in the tax court case hired experts to determine the value of the gifts. Shortly thereafter, decedent died and the parties settled the tax court case. The district court in the estate tax case issued an order holding that decedent's estate was entitled to a § 2053(a) deduction for the tax court claim and that the amount of the deduction should be fixed by the post-death settlement of the tax court case.<sup>105</sup> The Eleventh Circuit reversed, holding that the deduction should be determined without taking into account events that occurred after decedent's death.<sup>106</sup> The Eleventh Circuit then remanded the valuation issue to the district court.<sup>107</sup>

On remand decedent's estate established the status of the tax court proceeding at the time of decedent's death through the testimony of the estate's attorney and documents from those proceedings. The estate then offered expert testimony on the value of the claims as of decedent's death.<sup>108</sup> The experts testified about "the date-of-death value of the claims . . . based upon the likely outcome of the . . . [tax court case] given the facts known as of . . . [decedent's] death."<sup>109</sup> The experts then discounted that value to reflect contingencies related to possible litigation between decedent and the donees.<sup>110</sup> The district court

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101. *Id.*

102. *Id.* at 1261 (quoting *Shepherd*, 115 T.C. at 387).

103. *Id.* (footnote omitted).

104. 228 F. Supp. 2d at 1292.

105. *Id.* at 1292-95.

106. *Id.* at 1295.

107. *Id.*

108. *Id.* at 1297.

109. *Id.*

110. *Id.*

determined that the experts were qualified to render opinions on value and, accordingly, permitted the estate to take a deduction for the claim in an amount sufficient to eliminate the estate's tax liability.<sup>111</sup>

#### IV. IRS LEVY AND ASSESSMENT AUTHORITY

A number of the federal tax cases from 2002 concerned IRS authority to levy and assess tax. The topics covered by these cases include the types of property the IRS may levy against<sup>112</sup> and the extent to which the IRS may involve third parties in its collection and enforcement efforts.<sup>113</sup> These cases reflect the broadness of IRS levy and assessment authority in terms of being able to levy against just about any property interest over which the taxpayer has certain levels of control, being able to choose the most liquid assets to levy against, and being able to involve even unwilling third parties in collection efforts.

##### A. *IRS May Levy Against Entirety Property and IRAs*

In *United States v. Craft*,<sup>114</sup> the Supreme Court held that a tax lien against the taxpayer's "property" and "rights to property" also imposed a lien on taxpayer's interest in property held as tenant by the entirety.<sup>115</sup> In *Craft* a tax lien attached to taxpayer husband's property and rights to property when he failed to pay federal income tax liabilities assessed by the IRS.<sup>116</sup> At the time the lien attached, husband and wife owned, as tenants by the entirety, real property located in Michigan. After the lien attached, husband and wife quitclaimed the husband's interest to the wife. Years later, when the wife attempted to sell the property, the IRS consented to release its lien and permit the sale as long as the wife agreed to place one-half of the net proceeds from the sale in an escrow account pending a determination about the government's interest in the property. The wife sued in federal district court to quiet title to the escrow proceeds.

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111. *Id.* at 1302, 1305.

112. *See* *United States v. Craft*, 535 U.S. 274 (2002) (entirety property); *Sillavan v. United States*, No. CV-01-BU-803-5, 2002 U.S. Dist. LEXIS 2127 (N.D. Ala. Jan. 11, 2002) (IRAs).

113. *See* *Comyns v. United States*, 287 F.3d 1034 (11th Cir. 2002) (disclose taxpayer information to third parties); *Hovind v. Schneider*, No. 3:02cv297/RV/MCR, 2002 U.S. District LEXIS 22918 (N.D. Fla. 2002) (entering a third party's property); *Friedman v. United States*, No. 1:02-CV-2461-BBM, 2002 U.S. Dist. LEXIS 23496 (N.D. Ga. Sept. 24, 2002) (jeopardy assessment against payments from third party).

114. 535 U.S. 274 (2002).

115. *Id.* at 288.

116. *Id.* at 276; *see* I.R.C. § 6321 (2000).

In the district court, the government claimed that its lien had attached to the husband's entirety interest. The district court granted summary judgment in favor of the government and held that the transfer to the wife destroyed the tenancy by the entirety and entitled the government to one-half of the value of the property. On appeal, the Sixth Circuit held that because the husband lacked any individual interest in the property under state law, the tax lien did not attach to the property.<sup>117</sup> The United States Supreme Court granted certiorari "to consider the government's claim that the . . . husband had a separate interest in the entireties property to which the federal tax lien attached."<sup>118</sup>

The Supreme Court reversed the Sixth Circuit, concluding that despite state law to the contrary, each tenant by entirety possesses individual rights sufficient to constitute property or rights to property for the purposes of the tax lien.<sup>119</sup> The Court explained that it is appropriate to look to state law to determine taxpayer's rights in property.<sup>120</sup> The Court explained, however, that it is equally appropriate to look to federal law to determine whether taxpayer's state-defined rights qualify as property or rights to property for federal tax lien purposes.<sup>121</sup> The applicable state law provided that the husband's rights in entirety property included some of the most essential property rights such as the right to use, receive income from, and exclude others from the property.<sup>122</sup> The applicable federal law provides that the tax lien "is broad and reveals on its face that Congress meant to reach every interest in property that a taxpayer might have."<sup>123</sup> The Court explained that these essential state property rights gave the husband a substantial degree of control over the entirety property.<sup>124</sup> Accordingly, "[t]hese rights alone may be sufficient to subject the husband's interest in the entirety property to the federal tax lien."<sup>125</sup> However, in addition to

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117. 535 U.S. at 276-77.

118. *Id.* at 278.

119. *Id.* at 288.

120. *Id.*

121. *Id.*

122. *Id.* at 281. State law in Michigan provides that the husband's rights with respect to entirety property include (a) use of the property, (b) the right to exclude third parties from the property, (c) a share of income produced from the property, (d) the right of survivorship, (e) the right to become a tenant in common with equal shares upon divorce, (f) the right to sell the property with the wife's consent and to receive half the proceeds, (g) the right to encumber the property with the wife's consent, (h) the right to block wife from selling or encumbering the property unilaterally. *Id.* at 283-84.

123. *Id.* at 283 (quoting *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 719-20 (1985)).

124. *Id.*

125. *Id.*

these control rights, the husband also has the right to sell the property and a right of survivorship with respect to the property.<sup>126</sup> Thus, the Court held that the tax lien properly attached to the husband's interest in the entirety property.<sup>127</sup>

In *Sillavan v. United States*,<sup>128</sup> the district court held that the IRS may properly levy upon a taxpayer's IRA funds when no other liquid assets are readily available for levy.<sup>129</sup> In *Sillavan* the taxpayer sought a redetermination of an IRS administrative decision that would allow the IRS to levy on two of taxpayer's IRAs to satisfy a tax liability. The IRS assessed the tax liability against the taxpayer as a responsible person pursuant to § 6672<sup>130</sup> for payroll taxes that had not been paid. During the collections process, the taxpayer transferred his interest in his residence to his wife. After the transfer, the taxpayer consented to assessment and collection of the tax penalty. The IRS then indicated that it intended to collect the tax liability through a levy against two of taxpayer's IRAs. Later, the IRS filed a tax lien against the taxpayer's wife's residence to secure the tax penalty against the husband. After an administrative hearing concerning the intent to levy on the IRA accounts, the IRS Appeals Officer explained that he considered several proposed alternatives to the levy against the IRA, but concluded that none of the alternatives was appropriate.<sup>131</sup> The district court affirmed the IRS determination, concluding that no realistic alternative to levy against the IRAs existed.<sup>132</sup> Because of the uncertainty of taxpayer's future income<sup>133</sup> and his interest in the residence, the court rejected taxpayer's claims that an installment agreement or collection against the

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126. *Id.* at 283-84.

127. *Id.* at 288. Justice Thomas's dissent is very persuasive because he argues that the government's lien rights should not be any broader than a husband's ownership rights. *Id.* at 291 (Thomas, J., dissenting).

128. No. CV-01-BU-803-5, 2002 U.S. Dist. LEXIS 2127 (N.D. Ala. Jan. 11, 2002).

129. *Id.* at \*19.

130. I.R.C. § 6672.

131. 2002 U.S. Dist. LEXIS 2127, at \*2-6. Specifically, the Appeals Officer considered three alternatives: levy against other assets, an installment agreement, and an offer-in-compromise. The Appeals Officer rejected each of these alternatives because taxpayer claimed that he had no assets other than the IRA and whatever interest he retained in his residence, that his monthly expenses exceeded his monthly income, and that his assets exceeded his tax liability. *Id.* at \*6.

132. *Id.* at \*19.

133. Sections 6159 and 301.6159-1 of the Treasury Regulations authorize the IRS to enter into installment agreements to satisfy a federal tax liability. However, the IRS is not required to do so here because taxpayer's liability is not for income taxes arising under Subtitle A of the Internal Revenue Code and the aggregate amount of his liability exceeds \$10,000. See I.R.C. § 6159(c)(1).

proceeds from the sale of this residence were viable alternative collection methods.<sup>134</sup> Thus, the district court held that the IRS Appeals Officer did not abuse his discretion by approving the levy against the IRA accounts.<sup>135</sup>

*B. The IRS May Involve Third Parties in its Collection and Enforcement Efforts*

Three cases from 2002, *Comyns v. United States*,<sup>136</sup> *Friedman v. United States*,<sup>137</sup> and *Hovind v. Schneider*<sup>138</sup> concerned the extent to which the IRS may involve third parties in its tax collection and enforcement efforts.

In *Comyns* the Eleventh Circuit concluded that IRS agents will not be held liable for disclosing confidential taxpayer information to third parties so long as the IRS complies with its investigation procedures and training.<sup>139</sup> A taxpayer is permitted to sue any agent of the government who improperly discloses confidential taxpayer information to third parties.<sup>140</sup> However, the agent is not liable for the disclosure if it is made in good faith.<sup>141</sup> In a case of first impression, the Eleventh Circuit held that following IRS procedures and training satisfies the good faith requirement exception to § 7431(a) “because those procedures constitute a reasonable interpretation of the law by the IRS.”<sup>142</sup> Thus, the IRS agents may disclose confidential taxpayer information to third parties so long as they do not violate IRS procedures in doing so.<sup>143</sup>

In *Friedman* a federal district court concluded that the IRS may use its jeopardy assessment authority to collect monies owed to a delinquent taxpayer by a third party.<sup>144</sup> Under its jeopardy assessment authority, “if the Secretary . . . makes a finding that the collection of any tax is in jeopardy, notice and demand for immediate payment of such tax may be

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134. 2002 U.S. Dist. LEXIS 2127, at \*15. Regarding collecting from the sales proceeds of the residence, the court also explained that the IRS lien against taxpayer’s wife’s interest, as taxpayer’s nominee, could be subject to legal challenge by taxpayer’s wife if she were to assert that the transfer of taxpayer’s interest to her was bona fide and that she was not his nominee. *Id.* at \*18.

135. *Id.* at \*20-21.

136. 287 F.3d 1034 (11th Cir. 2002).

137. No. 1:02-CV-2461-BBM, 2002 U.S. Dist. LEXIS 23496 (N.D. Ga. Sept. 24, 2002).

138. No. 3:02cv297/RV/MCR, 2002 U.S. Dist. LEXIS 22918 (N.D. Fla. Oct. 31, 2002).

139. 287 F.3d at 1034.

140. See I.R.C. § 7431(a). Improper disclosure is defined by I.R.C. § 6103(a).

141. See *id.* § 7431(b).

142. 287 F.3d at 1034.

143. *Id.*

144. 2002 U.S. Dist. LEXIS 23496, at \*23.

made . . . and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period allowed for notice and demand.”<sup>145</sup> Within five days after the levy is imposed, the IRS must provide the delinquent taxpayer a written statement of the basis for the levy.<sup>146</sup> After the statement is furnished, the taxpayer may request a review of the levy and, thereafter, file an action in district court seeking review of the levy.<sup>147</sup> After the filing, the district court is required to determine whether the levy is reasonable.<sup>148</sup> A jeopardy levy is reasonable if the taxpayer appears to be planning to leave the United States, if the taxpayer appears to be planning to place his property “beyond the reach of the Government,” or if the taxpayer is becoming insolvent.<sup>149</sup> Taxpayer in *Friedman* filed a motion to determine the reasonableness of the IRS jeopardy assessment on taxpayer’s money due from a third party. The court concluded in *Friedman* that taxpayer’s financial solvency was properly found to be imperiled because taxpayer had failed to pay taxes or file returns for several years.<sup>150</sup>

Finally, in *Hovind*, a federal district court held that the IRS may enter a third person’s property in order to investigate a taxpayer’s tax liability.<sup>151</sup> In *Hovind* an IRS agent conducting an investigation into federal income tax liabilities went onto a third person’s property to serve several summons. Despite a posted “No Trespassing” notice, the IRS agent entered the property without obtaining prior consent and served the summons. The third party sought to enjoin the IRS from trespassing on his property.<sup>152</sup> The federal district court held that the injunction was barred by the Tax Anti-Injunction Act,<sup>153</sup> which provides that “no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person.”<sup>154</sup> Because the actions the third party sought to enjoin would impair IRS attempts to assess and collect taxes owed by the taxpayer, the court concluded that the Anti-Injunction Act was applicable.<sup>155</sup> While the Anti-Injunction Act provides for statutory exceptions, the third party did not assert that

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145. *Id.* at \*16-17. See I.R.C. § 6331(a).

146. 2002 U.S. Dist. LEXIS 23496, at \*17. See I.R.C. § 7429(a)(1)(B).

147. 2002 U.S. Dist. LEXIS 23496, at \*17. See I.R.C. §§ 7429(a)(2), (b)(1)-(2).

148. 2002 U.S. Dist. LEXIS 23496, at \*18. See I.R.C. §§ 7429(b)(3), (c).

149. 2002 U.S. Dist. LEXIS 23496, at \*22.

150. *Id.* at \*22-23.

151. 2002 U.S. Dist. LEXIS 22918, at \*6.

152. *Id.* at \*3-4.

153. I.R.C. § 7421(a).

154. 2002 U.S. Dist. LEXIS 22918, at \*4 (quoting I.R.C. § 7421(a)).

155. *Id.* at \*6.

any of the exceptions applied.<sup>156</sup> Because the party seeking an injunction bears the burden of demonstrating that an exception applies and because the third party failed to do so, the district court dismissed the third party's injunction action.<sup>157</sup>

#### V. BANKRUPTCY DISCHARGE

Two of the federal tax cases decided in 2002, *Young v. United States*<sup>158</sup> and *In re McDermott*,<sup>159</sup> concerned the ability of taxpayers to have their tax liabilities discharged in bankruptcy. More specifically, these bankruptcy discharge cases addressed the issue of the time at which a tax lien is discharged in a bankruptcy proceeding. The two aspects of the timing issue addressed in these cases were the tolling of the three-year lookback period and the due date of a tax return. The essence of these cases is that a taxpayer may not use bankruptcy to avoid tax liability by either artfully filing successive bankruptcy actions or by filing a needless automatic extension to create uncertainty about a tax return's "due date" for bankruptcy statute of limitations purposes.

##### A. *The Three-year Lookback Period in Bankruptcy is Tolled During Pendency of a Prior Bankruptcy Petition*

One determinant of the time at which a tax lien is discharged in bankruptcy is the three-year lookback period. The three-year lookback period provides that a discharge in bankruptcy does not extinguish tax liabilities for which a return was due within three years before the filing of an individual debtor's bankruptcy petition.<sup>160</sup> The issue before the Supreme Court in *Young* was whether this three-year period is tolled during the pendency of a prior bankruptcy petition.<sup>161</sup> If the three-year period is tolled during the prior proceeding, a bankrupt taxpayer cannot file successive bankruptcy petitions as a means of preventing the government from filing tax liens for unpaid tax assessments. If the three-year period is not tolled during the prior proceeding, a bankrupt taxpayer might be able to prevent the IRS from filing the lien, thus effectively discharging the tax liability in bankruptcy.<sup>162</sup> The Supreme

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156. *Id.* at \*5.

157. *Id.* at \*6.

158. 535 U.S. 43 (2002).

159. No. 3:01-CV-1387-J-20, 2002 U.S. Dist. LEXIS 20228 (M.D. Fla. Sept. 10, 2002).

160. 11 U.S.C. §§ 523(a)(1)(A) and 507(a)(8)(A)(i) (2000).

161. 535 U.S. at 44.

162. *Id.* at 48-49.

Court in *Young* held that the three-year period is indeed tolled during the pendency of a prior bankruptcy petition.<sup>163</sup>

In *Young* the bankrupt taxpayers filed a tax return for 1992 but did not include payment with the return, which was due in October 1993. The IRS assessed the 1992 tax liability in 1994. In 1994 and 1995, the bankrupt taxpayers made some payments on the assessment for 1992 but stopped making payments in 1996 after filing for Chapter 13 bankruptcy. At the time of their Chapter 13 bankruptcy filing, a portion of the 1992 tax liability remained due. Before a reorganization plan was confirmed, the bankrupt taxpayers moved to dismiss their Chapter 13 bankruptcy petition. In 1997, one day before the bankruptcy court dismissed the Chapter 13 petition, the taxpayers filed a new bankruptcy petition under Chapter 7. The bankruptcy court granted a discharge under this second petition on June 17, 1997, and closed the case on September 22, 1997. Later, the IRS demanded payment of the 1992 tax debt, but the taxpayers refused to pay, claiming that payment was barred by the three-year lookback period because the tax debt related to a return due more than three years prior to the Chapter 7 bankruptcy filing. The bankruptcy court refused to declare the tax debt discharged, explaining that although the tax return was due more than three years before the Chapter 7 petition, it was due less than three years before the 1996 Chapter 13 petition. The bankruptcy court agreed with the government, concluding that the “three-year lookback period” is tolled during the pendency of a prior bankruptcy petition.<sup>164</sup> The Supreme Court affirmed.<sup>165</sup>

The Court in *Young* rejected the taxpayers’ argument that the three-year lookback period is a substantive component of bankruptcy law, and not a mere procedural limitations period.<sup>166</sup> The taxpayers argued that because the lookback period begins on the date the tax return is due, not on the date the IRS discovers or assesses the unpaid tax, the effect is that the IRS may have less than three years to protect itself from discharge of a tax debt in bankruptcy.<sup>167</sup> The Court disagreed with this argument because otherwise all statutes of limitations would be rendered substantive.<sup>168</sup> The Court also noted that all limitations periods are subject to equitable tolling, unless tolling is “inconsistent

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163. *Id.* at 47.

164. *Id.* at 44-45.

165. *Id.* at 54.

166. *Id.* at 48-49.

167. *Id.* at 48.

168. *Id.* at 49-50.

with the text of the relevant statute.”<sup>169</sup> The Court recognized that equitable tolling typically applies “where the claimant has actively pursued his judicial remedies by filing a defective pleading during the statutory period, or where the complainant has been induced . . . by his adversary’s misconduct into allowing the filing deadline to pass.”<sup>170</sup> However, the Court noted that tolling may also be appropriate in a case like *Young* when the Chapter 13 bankruptcy petition creates an automatic stay that prevents the IRS from collecting, or filing a lien for, its tax debt.<sup>171</sup> Because taxpayers filed the Chapter 7 petition before the bankruptcy court dismissed the Chapter 13 petition, according to the Court, equity required that the limitations period be tolled during the pendency of the Chapter 13 petition.<sup>172</sup>

Finally, the Court in *Young* rejected each of taxpayers’ claims that certain statutory provisions precluded tolling.<sup>173</sup> Thus, the Court rejected the argument that § 523(b), which permits discharge in a Chapter 7 case of debts that were “excepted from discharge” in a prior Chapter 13 case, prevents tolling.<sup>174</sup> The Court explained that taxpayers’ tax debt here was not “excepted from discharge” in the Chapter 13, but was instead dismissed by the bankruptcy court before discharge.<sup>175</sup>

The Court also rejected taxpayers’ argument that, by negative implication, two statutes prevent tolling—§ 108(c)(1)<sup>176</sup> (tolling in nonbankruptcy courts) and § 507(a)(8)(A)(ii)<sup>177</sup> (240-day lookback period for offers-in-compromise).<sup>178</sup> With regard to § 108(c)(1), taxpayers argued that explicit tolling for nonbankruptcy courts indicates that if Congress wanted to provide for tolling in bankruptcy courts, it would have.<sup>179</sup> The Court refused to draw any such negative inference, concluding that it would not be unreasonable for Congress to provide for tolling in nonbankruptcy contexts, while at the same time assuming that bankruptcy courts would use their inherent equitable powers for tolling.<sup>180</sup> With regard to § 507(a)(8)(A)(ii), the taxpayers again argued by negative implication that the presence of explicit tolling for the

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169. *Id.* (quoting *United States v. Beggerly*, 524 U.S. 38, 48 (1998) (citations omitted)).

170. *Id.* at 50 (quoting *Irwin v. Dep’t of Veterans Affairs*, 498 U.S. 89, 96 (1990)).

171. *Id.*

172. *Id.* at 50-51.

173. *Id.* at 52.

174. *Id.* at 51-52.

175. *Id.* at 50-51.

176. 11 U.S.C. § 108(c)(1) (2000).

177. *Id.* § 507(a)(8)(A)(ii).

178. 535 U.S. at 52-53.

179. *Id.* at 52.

180. *Id.*

240-day lookback period precluded tolling in *Young*, primarily because the 240-day period is contained in the same subsection as the three-year period.<sup>181</sup> The Court also rejected this second negative implication argument because equitable tolling cannot apply to the 240-day period, which only applies when a claimant voluntarily chooses not to protect rights by entering into an “offer-in-compromise.”<sup>182</sup> Thus, it made sense, according to the Court, that explicit tolling be incorporated into the statute.<sup>183</sup>

*B. Automatic Extension Determines the Due Date of the Return for Purposes of Determining Discharge in Bankruptcy*

In addition to the three-year lookback period, another determinant of the time at which a tax lien is discharged in bankruptcy is the due date of the underlying tax return. As previously explained, taxes are excepted from discharge if they are “for a taxable year ending on or before the date of filing of the petition for which a return . . . is last due, including extensions, after three years before the date of the filing of the petition.”<sup>184</sup> For purposes of this three-year lookback period, “the due date of the return is dispositive and the date the return is actually filed is immaterial” in determining whether a debtor’s tax obligation is dischargeable.<sup>185</sup> Thus, the lookback period begins on the date the tax is “last due, including extensions,” not the date the return is filed if the extension was not used.<sup>186</sup> The issue in *In re McDermott*<sup>187</sup> was whether an automatic extension that turns out to be unnecessary determines the due date of the return for purposes of this three-year lookback period.<sup>188</sup>

On April 15, 1997, the bankrupt taxpayers in *McDermott* filed an automatic extension request with the IRS, along with their 1996 tax return and partial payment of their 1996 tax liability. The automatically extended due date for the 1996 tax return was August 15, 1997, four months after the regular due date.<sup>189</sup> The bankrupt taxpayers filed a bankruptcy petition on May 4, 2000 (three years and two weeks after filing their 1996 tax return but less than three years before the

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181. *Id.* at 53.

182. *Id.*

183. *Id.*

184. *In re McDermott*, 2002 U.S. Dist. LEXIS 20228, at \*4 (quoting *In re Wood*, 78 B.R. 316, 320 (M.D. Fla. 1989)). See 11 U.S.C. § 523(a)(1).

185. 2002 U.S. Dist. LEXIS 20228, at \*4 (quoting *In re Wood*, 78 B.R. at 320).

186. *Id.* at \*4-5.

187. *Id.* at \*3.

188. *Id.*

189. *Id.* at \*2. See 26 C.F.R. 1.6081-4(a)(2)-(4) (2000).

automatically extended filing deadline). In the bankruptcy proceeding, the bankrupt taxpayers sought to discharge their 1996 tax liability, claiming that the extension application was mooted because of their timely 1996 tax return. Taxpayers also argued that the extension application was not valid because it did not accurately identify the amount due. Thus, the bankrupt taxpayers argued that the “due date” for purposes of the three-year lookback rule was the date the return was filed, April 15, because the extension turned out to be unnecessary and invalid. Because more than three years passed between this due date (April 15, 1997) and their bankruptcy filing (May 4, 2000), taxpayers claimed that the bankruptcy case discharged their 1996 tax liability.<sup>190</sup> The bankruptcy court agreed with taxpayers, and the government appealed to the district court.<sup>191</sup>

The district court reversed the bankruptcy court.<sup>192</sup> The district court rejected the bankruptcy court’s conclusion that the bankrupt taxpayers’ extension was invalid due to its failure to properly indicate an estimate of taxes due.<sup>193</sup> The district court explained that the cases relied on by the bankruptcy court involved the IRS taking affirmative steps to deny taxpayers’ extensions while in this case the government never notified the bankrupt taxpayers that their extension was invalid or void.<sup>194</sup> Even if the extension was voidable due to the taxpayers’ failure to make a good-faith estimate of their tax liability, the district court explained that only the government can—at its discretion—void the automatic extension.<sup>195</sup> The district court concluded that the automatic extension was not voided merely because the bankrupt taxpayers’ application inaccurately estimated their tax.<sup>196</sup> The district court also explained that even if the extension was unnecessary and taxpayers did not benefit from it, they would benefit considerably from a declaration that their extension application was invalid because of an inaccurate estimate of tax due.<sup>197</sup> Thus, the district court concluded that “it would be unfair to allow [the bankrupt taxpayers] to benefit from circumstances driven by their own blatant noncompliance with the IRS regulations for seeking extensions.”<sup>198</sup>

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190. 2002 U.S. Dist. LEXIS 20228, at \*4.

191. *Id.* at \*3-4.

192. *Id.* at \*10.

193. *Id.* at \*7.

194. *Id.* at \*8.

195. *Id.* at \*9.

196. *Id.*

197. *Id.* at \*9-10.

198. *Id.* at \*10-11.

## VI. OTHER TAX CASES

In addition to cases concerning FICA, estate and gift tax, IRS levy authority, and bankruptcy discharge, the federal courts also decided three cases in 2002 that do not fit within these categories.

*A. A Parent Does Not Own its Subsidiary's Inventory for Purposes of Sub-chapter S LIFO Recapture*

In *Coggin Automotive Corp. v. Commissioner*,<sup>199</sup> the Eleventh Circuit held that a holding company is not treated as an additional owner of its subsidiaries' inventory for purposes of the sub-chapter S last-in first-out ("LIFO") recapture provisions.<sup>200</sup> A C-corporation that elects S-corporation status and that used the LIFO inventory method for its last taxable year prior to the election must recapture and include in gross income the difference between the LIFO inventory method and the first-in first-out ("FIFO") inventory method.<sup>201</sup> The purpose of this provision is to supplement and strengthen the built-in gains tax provisions of § 1374.<sup>202</sup> In *Coggin* the taxpayer, a holding company, operated as a C-corporation that owned majority interests in five subsidiary C-corporations. The subsidiaries owned inventories of vehicles for sale in their automobile dealerships. The subsidiaries elected to maintain these inventories using LIFO accounting.<sup>203</sup> The taxpayer never owned inventory directly and, hence, never made a LIFO inventory election. To facilitate a corporate restructuring, the taxpayer converted from C-corporation status to S-corporation status.<sup>204</sup> The tax court held that as a result of the conversion, the taxpayer had to include in income its share of LIFO recaptured reserves.<sup>205</sup> On appeal, the Eleventh Circuit reversed the tax court, ruling that the taxpayer did not own inventory and, thus, could not be subjected to the LIFO recapture rules.<sup>206</sup> The Eleventh Circuit rejected the tax court's reliance on legislative history, explaining that resort to legislative history was not appropriate because the plain language of the LIFO recapture statute provides that the

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199. 292 F.3d 1326 (11th Cir. 2002).

200. *Id.* at 1333-34; *see* I.R.C. § 1363 (2000).

201. 292 F.3d at 1329; *see* I.R.C. § 1363(d).

202. 292 F.3d at 1330.

203. *Id.* at 1328-29; *see* I.R.C. § 472. Under LIFO the cost of the most recently acquired goods is subtracted from current revenue to determine profit from inventory sales. 292 F.3d at 1330.

204. 292 F.3d at 1331.

205. *Id.*

206. *Id.* at 1333.

electing corporation must have owned inventory.<sup>207</sup> Thus, because the taxpayer did not own inventory, it could not be held liable for the LIFO recapture tax.<sup>208</sup>

*B. Case of First Impression Does Not Render IRS Prosecution Substantially Justified for Purposes of Attorney Fee Suit*

In *Wilkes v. United States*,<sup>209</sup> the Eleventh Circuit held that the government was not “substantially justified” when it took a position in a case of first impression that was inconsistent with the plain language of the governing statute.<sup>210</sup> Private parties who prevail “in any administrative or court proceeding which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty” are entitled to attorney fees.<sup>211</sup> In *Wilkes* the underlying case concerned whether an estate was liable for the portion of the estate tax liability that an employee stock ownership plan (“ESOP”) agreed to pay.<sup>212</sup> The estate argued that the executor was discharged in his representative capacity.<sup>213</sup> Conversely, the government argued that the statute discharged the executor’s personal liability and that the estate remained liable. The district court concluded that the executor was discharged in his representative capacity. Thereafter, the estate filed a motion for attorney fees, arguing that the government’s position lacked substantial justification.<sup>214</sup> The Eleventh Circuit held that the district court did not abuse its discretion in awarding attorney fees to the estate.<sup>215</sup> The Eleventh Circuit rejected the government’s argument that its position was substantially

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207. *Id.* at 1332.

208. *Id.* at 1333-34.

209. 289 F.3d 684 (11th Cir. 2002).

210. *Id.* at 689-90.

211. *Id.* at 686 (quoting I.R.C. § 7430(a)).

212. *Id.* at 688-89. After decedent died, the executor agreed to sell shares of stock previously owned by decedent to an ESOP. The executor elected to have I.R.C. § 2210 apply, which relieved the executor of liability for a portion of the estate taxes if an ESOP bought the employer securities and agreed to pay that portion of the estate tax liability. The ESOP agreed to pay a portion of the estate taxes due but failed to do so. After the ESOP defaulted, the IRS tried to collect the unpaid estate taxes from the estate. *Id.* at 685.

213. I.R.C. § 2210(a) provided: “The executor is relieved of liability for the payment of that portion of the tax . . . which such . . . [ESOP] is required to pay.” *Id.* at 688 (quoting I.R.C. § 2210(a) (1988)).

214. *Id.* at 686. “A position that is ‘substantially justified’ is one that is justified to a reasonable degree that could satisfy a reasonable person or that has a reasonable basis in both law and fact.” *Id.* at 688 (citing *In re Rasbury*, 24 F.3d 159 (11th Cir. 1994)).

215. *Id.*

justified on the grounds that the case was one of first impression.<sup>216</sup> The court explained that all of the considerations of statutory construction indicated that “the term ‘executor’ refers to the executor in his representative capacity.”<sup>217</sup> The mere possibility that the term executor could mean personal capacity, without any plausible reason why it should, was not sufficient.<sup>218</sup>

*C. Injunction Against Accountants as Tax Preparers Is Appropriate When They Continually and Repeatedly Engaged in Prohibited Conduct*

In *United States v. Ratfield*,<sup>219</sup> the federal district court held that accountants who repeatedly and continually engaged in proscribed conduct were properly enjoined from acting as tax preparers in the future.<sup>220</sup> In *Ratfield* the government alleged that accountant defendants marketed arrangements involving the transfer of individual taxpayers’ businesses to common law trusts. After the transfer, the business income and expenses were reported on the trust income tax return as profit and loss from a business. Some of the items deducted against the trust income in these cases included taxpayer’s personal living expenses, medical bills, contributions to private pension plans, and ordinary insurance premiums. Additionally, federal income tax liabilities of the trust purchasers were artificially reduced by employing the trust purchaser as the general manager of the trust, which paid the individual taxpayer a yearly salary instead of the income. This trust arrangement produced a significant understatement of the trust purchaser’s federal tax liabilities. Accountant defendants promoted these trusts, having sold over one hundred of them.<sup>221</sup> A court may award injunctive relief prohibiting specific conduct if the court finds that a tax preparer has engaged in activity that contravenes § 7407(b), which includes any “fraudulent . . . conduct which substantially interferes with

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216. *Id.* at 689-90.

217. *Id.* at 688-89.

218. *Id.* at 689.

219. No. 01-8816-CIV-FERGUSON, 2002 U.S. Dist. LEXIS 21450 (S.D. Fla. Sept. 29, 2002).

220. *Id.* at \*9-10.

221. *Id.* at \*2-4.

the proper administration of the [tax] laws."<sup>222</sup> Section 7407 also states that

if the court finds that an income tax return preparer has continually or repeatedly engaged in any conduct described in [7407(d)(1)] and that an injunction prohibiting such conduct would not be sufficient to prevent such person's interference with the proper administration of [income tax laws], the court may enjoin such person from acting as an income tax return preparer.<sup>223</sup>

Thus, the court concluded that the injunction was proper.<sup>224</sup>

#### VII. CONSTITUTIONALITY OF PUBLIC DISCLOSURE LAW FOR TAX-EXEMPT POLITICAL ORGANIZATIONS

The most important tax case decided in the Eleventh Circuit in 2002 was *National Federation of Republican Assemblies v. United States*.<sup>225</sup> *National Federation* is important because it addressed constitutional law issues, as opposed to statutory issues, that relate to tax law. Specifically, the issues in *National Federation* were (1) whether tax-exempt political organizations have standing to challenge the constitutionality of a disclosure statute, and (2) whether that disclosure statute is constitutional under the First, Fifth, and Tenth Amendments to the United States Constitution.<sup>226</sup> The district court concluded that tax-exempt political organizations have standing to challenge the disclosure statute.<sup>227</sup> Further, the court held that the disclosure statute itself is constitutional in part and unconstitutional in part.<sup>228</sup>

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222. I.R.C. § 7407(b) provides that an injunction is appropriate if the court finds that the income tax preparer has:

- (A) engaged in any conduct subject to penalty under [§] 6694 or 6695, or subject to any criminal penalty provided by this title,
  - (B) misrepresented his eligibility to practice before the Internal Revenue Service, or otherwise misrepresented his experience or education as an income tax preparer,
  - (C) guaranteed the payment of any tax refund or the allowance of any tax credit, or
  - (D) engaged in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws, and [the Court finds]
- (2) that injunctive relief is appropriate to prevent the recurrence of such conduct.

223. I.R.C. § 7407.

224. 2002 U.S. Dist. LEXIS 21450, at \*9-11.

225. 218 F. Supp. 2d 1300 (S.D. Ala. 2002).

226. *Id.* at 1307.

227. *Id.* at 1313.

228. *Id.* at 1354-55.

A political organization is organized and operated primarily for the purpose of accepting contributions or making expenditures for an exempt function.<sup>229</sup> The exempt function is essentially the function of influencing the public election process.<sup>230</sup> A political organization is generally subject to income taxation on its taxable income.<sup>231</sup> Taxable income is the excess of gross income for the year (minus exempt function income) over allowed deductions that are directly connected with the production of that income (minus exempt function income), subject to certain modifications.<sup>232</sup> Exempt function income includes contributions, membership dues, proceeds from political fund-raising not received in the ordinary course of a trade or business, and proceeds from § 513(f)(2) bingo games.<sup>233</sup> The tax rate imposed on taxable income is generally thirty-five percent, the highest corporate rate.<sup>234</sup> Thus, a political organization receives an exemption from tax to the extent that its income relates to its principal purpose of influencing elections.

Congress recently added two disclosure provisions to § 527: §§ 527(i) and 527(j). The first disclosure provision, § 527(i), provides that a political organization is not treated as such unless it discloses to the government its name, address, purpose, and the identity of certain related persons.<sup>235</sup> Political organizations that anticipate gross receipts of less than \$25,000 in a year or that are subject to Federal Election Campaign Act of 1971 ("FECA")<sup>236</sup> disclosure do not have to make § 527(i) disclosures.<sup>237</sup> A political organization that does not make a § 527(i) disclosure when required loses the tax exemption for its exempt function income.<sup>238</sup>

The second disclosure provision, § 527(j), provides that a political organization that accepts a contribution or makes an expenditure for an

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229. I.R.C. § 527(e)(1) (2000).

230. *Id.* § 527(e)(D). An "exempt function" is:

the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

*Id.*

231. *Id.* § 527(a), (b)(1).

232. *Id.* § 527(c)(1).

233. *Id.* § 527(c)(3).

234. *See id.* §§ 527(b)(1), 11(b)(1)(D).

235. *Id.* § 527(i)(1)-(3).

236. 2 U.S.C. §§ 431-455 (2000).

237. I.R.C. § 527(i)(5)-(6).

238. *Id.* § 527(i)(4).

exempt function must make additional disclosures to the IRS.<sup>239</sup> These additional disclosures include (1) the amount of any expenditure in excess of \$500 and the name and address of the recipient, and (2) the amount of any contribution in excess of \$200 and the name and address of the contributors.<sup>240</sup> Organizations that do not have to make § 527(i) disclosures, namely political committees and organizations that make independent expenditures, do not have to make § 527(j) disclosures.<sup>241</sup> Organizations that fail to make required § 527(j) disclosures are taxed on the amount to which the failure relates.<sup>242</sup> The political organizations in *National Federation* alleged that § 527(j) disclosure requirements violated their First Amendment free speech and association rights, their Fifth Amendment equal protection rights, and the Tenth Amendment. In addition to disputing these constitutional law claims, the government argued that the political assembly plaintiffs lacked standing to make the claims.<sup>243</sup>

*A. Tax-Exempt Political Organizations Have Standing to Challenge the Constitutionality of the Disclosure Statute*

The political assembly plaintiffs in *National Federation* were “political organizations.” None of the assembly plaintiffs made § 527(i) disclosures, however, and all of them had a decline in contributions due to contributors’ concerns regarding identity disclosure. The government claimed that these political assemblies lacked standing to challenge the constitutionality of the § 527(j) disclosure statute.<sup>244</sup>

Standing requires three elements: (1) injury in fact, (2) causal connection between the injury and the aggrieved conduct, and (3) likelihood that the injury will be redressed by a favorable decision.<sup>245</sup> The government claimed that the political assembly plaintiffs lacked standing because they had not made § 527(i) disclosures and were not, therefore, required to make § 527(j) disclosures. Thus, the government contended that the assembly plaintiffs had not suffered any injury.<sup>246</sup> The court rejected this claim, explaining that even though the political assembly plaintiffs were not required to make § 527(j) disclosures, they suffered injury because the law forced them to choose between privacy

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239. *Id.* § 527(j)(2).

240. *Id.* § 527(j)(3).

241. *Id.* § 527(j)(5).

242. *Id.* § 527(j)(1).

243. 218 F. Supp. 2d at 1307.

244. *Id.*

245. *Id.* at 1308.

246. *Id.*

with respect to their larger contributions and disclosing those larger contributions.<sup>247</sup> According to the court, either option had adverse economic consequences: not disclosing meant that plaintiffs would pay a penalty and disclosing meant that they might lose larger contributions from those who were unwilling to publicize their support.<sup>248</sup> The court concluded that both of these potential consequences satisfied the “injury” requirement of standing.<sup>249</sup>

Even though the government did not challenge the other constitutionally mandated elements of standing, the court determined that they were satisfied.<sup>250</sup> The political assemblies’ “injury [was] fairly traceable to [§] 527(j) because, but for that statute, they would still be able to avoid [the penalty] without disclosing their larger contributions and expenditures.”<sup>251</sup> Further, the court explained that “[a] favorable decision [would] strike down [§] 527(j), redressing the Assembly plaintiffs’ injury by eliminating its source.”<sup>252</sup> The court concluded that plaintiffs had standing to challenge the constitutionality of § 527(j).<sup>253</sup>

#### B. *Constitutionality of the Disclosure Statute*

**1. Disclosure statute violates First Amendment with regard to expenditures, but not contributions.** The political organizations’ first constitutional law claim was that § 527(j) disclosure violated their First Amendment free speech rights.<sup>254</sup> The decision in *Buckley v. Valeo*<sup>255</sup> is ordinarily applied to determine the constitutionality under the First Amendment of disclosure requirements that affect political speech.<sup>256</sup> If *Buckley* applies, the disclosure requirements must be substantially related to an important governmental interest.<sup>257</sup> The government argued, however, that § 527(j) merely conditions a tax exemption on disclosure, thus satisfying the First Amendment independent of *Buckley*.<sup>258</sup> Therefore, one issue in *National Federation* was whether § 527(j) denied a tax subsidy because of speech, in which case

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247. *Id.* at 1310.

248. *Id.* at 1308-10.

249. *Id.* at 1310.

250. *Id.*

251. *Id.*

252. *Id.*

253. *Id.* at 1313.

254. *Id.*

255. 424 U.S. 1 (1976).

256. 218 F. Supp. 2d at 1313 (citing *Buckley*, 424 U.S. at 64).

257. *Id.* (citing *Buckley*, 424 U.S. at 64).

258. *Id.*

*Buckley* would apply,<sup>259</sup> or whether it denied a subsidy that underwrites speech, in which case *Buckley* would not apply.<sup>260</sup> The court explained that the § 527 tax exemption underwrites political speech.<sup>261</sup> As such, the statute provides a subsidy that “has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on [this] income.”<sup>262</sup> The court stated that “[t]his subsidy effectively allows the political organization to increase its expenditures and thus its speech.”<sup>263</sup> Because of this subsidy, the court concluded that, as applied to contributions, § 527(j) does not implicate the First Amendment.<sup>264</sup>

The political organizations argued that § 527 does not grant a tax exemption because Congress lacks authority to tax political speech due to its “unique character as First Amendment protected activity.”<sup>265</sup> Therefore, the political organizations claimed that § 527(j) could not offset any exemption from tax. Instead, they argued that § 527(j) imposed an additional penalty tax that implicated the First Amendment.<sup>266</sup> The court acknowledged that § 527 could not grant a tax exemption for contributions unless the exempted contributions were initially subject to income tax.<sup>267</sup> However, the court explained that § 527 does not tax contributors for exercising their right to contribute.<sup>268</sup> Rather, it taxes the recipient political organization on its income.<sup>269</sup> Because the federal income tax is a “generally applicable” tax, the court concluded that “the First Amendment does not immunize political contributions from income taxation.”<sup>270</sup> The political organizations also claimed that even if the First Amendment does not prohibit an income tax on political contributions, the Code does because (1) they

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259. For example, in the case of the I.R.C. § 501(c)(3) tax exemption that prohibits lobbying, the First Amendment is implicated because the government penalizes taxpayers for engaging in speech. *Id.* at 1313-14 (citing *Speiser v. Randall*, 357 U.S. 513, 518 (1958)).

260. *Id.* at 1314. For example, in the case of the I.R.C. § 501(c)(4) tax-exemption, which allows lobbying but denies the ability to receive tax-deductible contributions, the First Amendment is not implicated because Congress “merely refused to pay for the [speech] out of public monies.” *Id.* (quoting *Regan v. Taxation with Representation*, 461 U.S. 540, 545-46 (1983) (alteration in original)).

261. *Id.*

262. *Id.* (quoting *Regan*, 461 U.S. at 544) (alteration in original).

263. *Id.*

264. *Id.* at 1322.

265. *Id.* at 1314 (quoting Plaintiffs’ Brief at 8, 10).

266. *Id.*

267. *Id.*

268. *Id.* at 1315.

269. *Id.*

270. *Id.*

are not gross income,<sup>271</sup> (2) they are gifts exempted from gross income,<sup>272</sup> or (3) they are conduit payments.<sup>273</sup> The court rejected each of these claims because (1) the legislative history of § 527 says nothing about shielding contributions from tax, (2) the view of contributions as gifts is unsupported, and (3) the conduit theory does not apply because contributions are not generally held by the organizations as agents of contributors.<sup>274</sup> Thus, because political contributions are gross income, “they are subject to income tax unless effectively excluded from tax elsewhere in the Code.”<sup>275</sup> The court concluded that § 527 grants such a tax exemption.<sup>276</sup>

The court in *National Federation* outlined an important difference between disclosure of contributions and disclosure of expenditures for First Amendment analysis purposes.<sup>277</sup> The difference relates to the extent to which the penalty tax imposed for failing to make § 527(j) disclosures exceeds the amount of tax otherwise exempted by § 527.<sup>278</sup> While a law may withdraw a tax subsidy that underwrites taxpayer speech without implicating the First Amendment, if Congress does more than cancel a subsidy, the law must satisfy *Buckley*.<sup>279</sup> Regarding contributions, § 527(j) does no more than offset the subsidy (tax exemption) enjoyed by political organizations that give notice under § 527(i).<sup>280</sup> Regarding expenditures, however, the penalty for failing to make § 527(j) disclosures is imposed in exactly the amount of tax exemption the organization would receive for the same amount of exempt income.<sup>281</sup> To the extent the political organization’s exempt-function expenditures of \$500 or more exceed its tax-exempt income from undisclosed sources, § 527(j) ceases to represent the offset of a subsidy and becomes an additional exaction.<sup>282</sup> Thus, § 527(j) virtually guarantees that the penalty imposed will exceed the amount of the political organization’s tax-exemption because the effect is not simply to tax that which has been exempted. To the extent the political organization’s

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271. Gross income includes “all income from whatever source derived,” except as otherwise provided in subtitle A of the Code. I.R.C. § 61(a).

272. *Id.* § 102(a).

273. 218 F. Supp. 2d at 1315-17.

274. *Id.* at 1315-18.

275. *Id.* at 1318.

276. *Id.*

277. *Id.* at 1318-22.

278. *Id.* at 1319-20.

279. *Id.* at 1322.

280. *Id.*

281. *Id.*

282. *Id.*

exempt-function expenditures exceed its tax-exempt income, § 527(j) must satisfy the analysis under *Buckley* to survive the First Amendment challenge.<sup>283</sup>

Obtaining information about candidates' constituencies is an important governmental interest under *Buckley*.<sup>284</sup> Additionally, the disclosure requirements in *Buckley* were the least restrictive means of accomplishing this informational interest.<sup>285</sup> *Buckley* thus establishes that "Congress may constitutionally require disclosures of organizations whose major purpose is the nomination or election of candidates."<sup>286</sup> A political organization is an organization whose primary purpose is to influence the selection of individuals for public office,<sup>287</sup> much like the political committees at issue in *Buckley*.<sup>288</sup> However, § 527(j)'s expenditure disclosure requirements are much narrower than the disclosure requirements of FECA (the statute at issue in *Buckley*). Whereas § 527(j) requires disclosure for expenditures of \$500 or more, FECA's disclosure requirements are triggered at \$100.01.<sup>289</sup> Also, § 527(j) requires disclosure only of specific identifying information about the recipient, whereas FECA requires disclosure of both the purpose of each expenditure and the identity of the candidate to be assisted by the expenditure.<sup>290</sup> In a constitutional analysis, these differences are material.<sup>291</sup> FECA's expenditure disclosure requirements advanced the informational interest by "provid[ing] information linking the expenditure to a particular candidate."<sup>292</sup> Under § 527(j), however, political organizations are not required to identify the candidate.<sup>293</sup> Thus, except when identifying the recipient provides this information, such as when the candidate is the recipient, "[§] 527(j) is not calculated to advance the governmental interest on which *Buckley* rested."<sup>294</sup> Thus, the court concluded that "[§] 527(j) violate[d] the First Amendment to

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283. *Id.*

284. *Id.* at 1330 (citing *Buckley*, 424 U.S. at 80). Such information helps voters define the candidates' constituencies, alerts voters to candidates' likely interests, and allows voters to better compare candidates to one another. *Id.*

285. *Buckley*, 424 U.S. at 68.

286. 218 F. Supp. 2d at 1330.

287. I.R.C. § 527(e)(1), (2).

288. *See* 424 U.S. at 7-8.

289. 218 F. Supp. 2d at 1332-33.

290. *Id.* at 1333.

291. *Id.*

292. *Id.*

293. *Id.*

294. *Id.*

the extent it purported to require political organizations to disclose expenditures.”<sup>295</sup>

**2. Disclosure statute does not violate Fifth Amendment Equal Protection to the extent it requires contribution disclosure, but it does to the extent it requires expenditure disclosure.** The political organizations argued that § 527(j) disclosure violated the equal protection component of the Fifth Amendment’s Due Process Clause. The organizations claimed that § 527(j) singles them out for disclosures without requiring the same of other tax-exempt organizations that receive political contributions (or make political expenditures) but do not receive contributions or make expenditures as their primary purpose.<sup>296</sup> Because political speech is a fundamental right, strict scrutiny is required if the statute burdens this speech.<sup>297</sup> However, the government’s decision not to subsidize speech is not subject to strict scrutiny.<sup>298</sup> Thus, the conditioning of a tax benefit, though it may adversely impact the taxpayer’s speech, requires only rational basis review.<sup>299</sup> With respect to contributions, § 527(j) only offsets a tax benefit, but with respect to expenditures, it results in an additional exaction.<sup>300</sup> Accordingly, the court concluded that rational basis scrutiny applied to plaintiffs’ equal protection challenge to contribution disclosure, while strict scrutiny applied to their challenge to expenditure disclosure.<sup>301</sup>

Rational basis review of contribution disclosures for equal protection purposes requires that there be “‘a rational relationship between the disparity of treatment and some legitimate governmental purpose.’”<sup>302</sup> The court noted that other tax-exempt organizations, such as labor unions, are meaningfully different from political organizations because influencing electoral results is not the primary focus of these other organizations.<sup>303</sup> Given the government’s informational interest in § 527(j) disclosure, the court concluded that it is “rational for Congress to target those groups best able to influence electoral results.”<sup>304</sup> Thus, § 527(j) does not violate equal protection under the Fifth Amendment by

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295. *Id.* at 1336.

296. *Id.* Plaintiffs identified such political organizations as labor unions, social welfare organizations, and other organizations exempted from tax by § 501. *Id.*

297. *Id.* at 1336-37.

298. *Id.* at 1337.

299. *Id.*

300. *Id.* at 1337-38.

301. *Id.* at 1338.

302. *Id.* (quoting *Bd. of Trs. v. Garrett*, 531 U.S. 356, 367 (2001)).

303. *Id.*

304. *Id.*

failing to require other tax-exempt organizations engaged in electoral advocacy to make similar contribution disclosures.<sup>305</sup>

Strict scrutiny review of expenditure disclosures for equal protection purposes requires that “statutory classifications impinging upon a fundamental right must be narrowly tailored to serve a compelling government interest.”<sup>306</sup> Thus, strict scrutiny required the government in *National Federation* to identify the characteristics of political organizations that make them, but not other similarly engaged tax-exempt organizations, appropriate subjects for required expenditure disclosures.<sup>307</sup>

The legislative history of § 527(j) identifies two essential characteristics of political organizations: “(1) their primary purpose is to influence election results, and (2) the public cannot identify their supporters from their names.”<sup>308</sup> These explanations were insufficient under strict scrutiny because nothing in the record explained why it was more important to require expenditure disclosures of political organizations than for other tax-exempt organizations.<sup>309</sup> The court explained that while a primary purpose of influencing elections is a difference between the political organizations and other tax-exempt groups, it is not “a meaningful difference in a critical characteristic justifying different expenditure disclosure requirements.”<sup>310</sup> Further, the only compelling purpose suggested by the legislative history of § 527(j) is that extending the disclosure requirements to other tax-exempt organizations would raise First Amendment concerns.<sup>311</sup> However, to the extent that other tax-exempt organizations receive contributions for electoral advocacy, Congress could condition tax-exemption on the disclosure of expenditures.<sup>312</sup> Thus, the potential unconstitutionality of requiring other tax-exempt organizations to disclose expenditures is not a compelling reason for treating such organizations better than political organizations with respect to such disclosure.<sup>313</sup> The court concluded that § 527(j) violated Fifth Amendment Equal Protection guarantees to the extent it requires political organizations to disclose expenditures.<sup>314</sup>

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305. *Id.* at 1339.

306. *Id.* (quoting *Austin v. Mich. Chamber of Commerce*, 494 U.S. 652, 666 (1990)).

307. *Id.* at 1340-41.

308. *Id.* at 1341.

309. *Id.*

310. *Id.*

311. *Id.* at 1342.

312. *Id.* at 1343.

313. *Id.*

314. *Id.* at 1343-44.

**3. Disclosure statute violates Tenth Amendment to the extent it requires disclosures connected to federal electoral advocacy, but not to state advocacy.** Although Congress clearly has authority to regulate federal elections, plaintiffs in *National Federation* argued that § 527(j) “violates the Tenth Amendment to the extent it purports to require disclosures of political organizations operating in the state and local arena.”<sup>315</sup> The Tenth Amendment provides: “The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.”<sup>316</sup> Thus, under the Tenth Amendment, the issue in *National Federation* was whether federal disclosure in state and local elections is a matter that “but for the Constitution, would be subject to state sovereignty.”<sup>317</sup> Although regulation of state and local electoral advocacy is an attribute of state sovereignty, this does not establish that such regulation is reserved to the states.<sup>318</sup> As the court stated, “[I]f the power Congress exercised was delegated to it, that power cannot have been reserved to the states.”<sup>319</sup> However, before addressing Congress’s power to impose disclosure requirements for state and local electoral advocacy, Congressional intent must be considered.<sup>320</sup> The court concluded that Congress clearly expressed its intention by defining “political organization” as any organization whose primary purpose is to influence the selection of an individual for state or local office.<sup>321</sup> The only exclusion possibly exempting political organizations in state and local electoral advocacy<sup>322</sup> does not reach all political organizations engaged in such advocacy.<sup>323</sup> Thus, because Congress clearly ex-

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315. *Id.* at 1344.

316. U.S. CONST. amend. X.

317. 218 F. Supp. 2d at 1344.

318. *Id.* at 1344-45.

319. *Id.* at 1345.

320. *Id.*; see *Gregory v. Ashcroft*, 501 U.S. 452, 461, 464 (1991).

321. 218 F. Supp. 2d at 1346 (citing I.R.C. § 527(e)(1)-(2)).

322. See I.R.C. § 527(j)(5)(B) (providing an exclusion for “any State or local committee of a political party or political committee of a State or local candidate”).

323. 218 F. Supp. 2d at 1346. The court explains:

A “committee of a political party” plainly cannot extend to a political organization not affiliated with a political party. The term “political committee of a State or local candidate,” while somewhat less precise, cannot plausibly be stretched to mean, “all political organizations engaged in state or local electoral advocacy.” Section 527 identifies a “committee” as only one form of organization constituting a political organization, [I.R.C.] § 527(e)(1), so that an exclusion for a “committee” cannot be an exclusion for other forms of organization falling within [§] 527. Moreover, the only committees excluded are those “of” a state or local candidate;

pressed its intent to regulate state and local electoral advocacy, the issue was whether Congress's enactment of § 527(j) was done pursuant to a power delegated by the Constitution.<sup>324</sup>

The government claimed that Congress's taxing power supports § 527(j)'s application to state and local elections.<sup>325</sup> The court rejected this claim.<sup>326</sup> The court agreed that because every tax is in some way regulatory, "a tax is not any the less a tax because it has a regulatory effect."<sup>327</sup> A tax having a regulatory effect can become a mere penalty, however, at which point the statute violates the Tenth Amendment.<sup>328</sup> Thus, the constitutionality of § 527(j) "depends on whether Congress intended to exercise its constitutional power to tax or intended instead to regulate state and local [elections]."<sup>329</sup> The court concluded that Congress clearly designated the fee imposed for failure to make § 527 disclosures as a "penalty," that is, a sanction for the failure to disclose contributions and expenditures for state and local elections.<sup>330</sup> The court rejected the government's claim that § 527(j) has a revenue purpose, which is "ensuring that federal subsidies are not used in a manner that might lead to corruption or would conceal the source of campaign-related spending from the public."<sup>331</sup> Indeed, the court explained that to the extent § 527(j) imposes a penalty in excess of the political organization's tax exemption (i.e., its federal subsidy), it is imposed purely to coerce disclosures.<sup>332</sup> Insofar as § 527(j) offsets a tax exemption, it does not do so to raise revenue.<sup>333</sup> Additionally, the court refused to consider § 527(j) disclosure as supporting a revenue purpose because it does not assist in identifying taxpayers, confirming that taxpayers are using the correct tax status, determining the amount of tax liability, or collecting tax.<sup>334</sup> Because § 527(j) is not a revenue measure and does not serve any revenue purpose, the court in *National Federation* concluded that it "reflects Congress's purpose to regulate

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this possessive preposition cannot reasonably be read as extending the exclusion beyond a candidate's own campaign committee.

*Id.*

324. *Id.* at 1347.

325. *Id.*

326. *Id.* at 1348.

327. *Id.* at 1347 (quoting *Sonzinsky v. United States*, 300 U.S. 506, 513 (1937)).

328. *Id.* at 1347-48.

329. *Id.*

330. *Id.* at 1349.

331. *Id.* at 1350 (quoting Defendant's Brief at 14).

332. *Id.*

333. *Id.* at 1351.

334. *Id.*

state and local electoral advocacy and not to exercise its taxing power.”<sup>335</sup> Accordingly, § 527(j) “violates the Tenth Amendment to the extent that it purports to require disclosures of contributions and expenditures in connection with state and local advocacy.”<sup>336</sup>

#### IX. CONCLUSION

The federal cases decided in 2002 that impact tax law in the Eleventh Circuit are varied and enlightening. These cases show just how expansive and rich tax law can be. The topics addressed by these cases include business (e.g., payroll tax and corporate tax) and personal matters (e.g., estate and gift tax, IRS authority to levy on entirety property, and IRAs), statutory and constitutional law issues, and liability for tax obligations incurred by third persons. It is also instructive that the government prevailed in an overwhelming majority of these tax cases. Thus, a taxpayer who hopes to escape liability for the most basic of civic responsibilities—paying taxes—faces a significant challenge. Many of the cases in which taxpayers were held liable seem a bit extreme, such as when restaurants were held liable for taxes on estimates of income they never paid, when officers or directors were held liable for taxes that another person was supposed to pay, and when an estate was denied a charitable deduction for monies paid to charity. Nevertheless, this severity is necessary in order to maintain the integrity of a voluntary compliance federal taxation system.

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335. *Id.* at 1352.

336. *Id.*