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MESSAGE FROM THE CHAIR

Greetings to the Tax Procedure and Litigation Committee!

At our last meeting, we had the opportunity of attending the Annual Tax Meeting and discuss papers for the upcoming Washington D.C. Delegation. We will have strong representation in Washington D.C.,

and, among other things, will have the opportunity to share our thoughts and concerns with the U.S. Tax Court on several topics. Please send me any comments you have regarding all or any of (a) the U.S. Tax Court's new electronic filing system, effective this year, (b) technical issues and anomalies encountered by you if you are involved with litigation before the U.S. Tax Court, (c) innocent spouse trial issues, (d) Levy/CDP cases, and (e) U.S. Tax Court Rules (effective January 1, 2010). I will bring these concerns to the attention of the U.S. Tax Court Judges.

TOPICS FOR 2010 ANNUAL TAX BAR MEETING (NOVEMBER 4-6, 2010 AT LOEW'S CORONADO)

Speaking of the Annual Tax Meeting, at our next meeting in Sacramento, on February 5th, at the offices of the Board of Equalization, the Chair of this year's 2010 Annual Tax Bar Meeting & California Tax Policy Conference, namely, our illustrious immediate past Chair, Kornelia Brown, needs our Committee to propose seven to nine educational programs that are both timely and of interest to the corporate and business tax practitioner vis-à-vis tax procedure and litigation. The Committee needs to name the proposed programs and provide a short two or three sentence description of each proposed program topic. The foregoing topic proposals need to be submitted to Kornelia on or before February 19th – therefore, please attend the meeting in Sacramento prepared with some topics, but if you are unable to attend please forward any topics you may want proposed to me before February 5th. Your help is urgently needed.

ELECTIONS (AGAIN?)

In addition to the foregoing, the Committee will also open nominations for the 2010-2011 2nd Chair (and Editor), and hold an election at our February 5th meeting. As you recall, do to a resignation, we nominated and appointed our present 2nd and 1st Vice-

Chairs at the November meeting. We are NOT replacing either. Because the slate of officers for our Committee now needs to be approved by the Executive Committee for the next year at ExComm's March meeting, the Committee needs to hold this election for the 2nd Vice-Chair at our February Committee Meeting. Of course, because we are having this election so early, the Committee will keep the 2nd-Vice Chair elect involved this year as well. If you want to be nominated or want to nominate someone please attend the meeting, or, if you cannot attend, then let me know if you are interested.

CALIFORNIA TAX LAWYER

If you wish to have a "Quick Point" included in the upcoming issue of the California Tax Lawyer, please send me any brief technical updates, procedural updates, observations on practice or policy matters, and commentaries you may want included. I need to receive such BEFORE February 1, 2010, to get it to the California Tax Lawyer in time to be included in the next edition.

BRING YOUR CAMERA TO THE QUARTERLY COMMITTEE MEETINGS

If there is room in each issue of the California Tax Lawyer, the editors would like to include pictures of our activities. Please send me via e-mail any JPEGs you may have from our meetings, and be sure to identify each person in the photo and the event at which the photo was taken.

SPEAKER AT THE FEBRUARY 5th MEETING IN SACRAMENTO

At our next meeting in Sacramento, at the headquarter offices of the Board of Equalization, in the Board Hearings Room on the first floor, 450 N. Street, the Chair-Elect has invited Bradley Heller, Tax Counsel III Legal Administration, Tax and Fee Division, to discuss the changes that can be expected for businesses, including lawyers, who are not retail sellers as a result of ABX 4-18, which requires "qualified purchasers," which would include lawyers whose gross receipts are over \$100,000, to file quarterly use tax returns. He will also address procedures followed in sales tax appeals within the BOE. Also, Todd Gilman, Taxpayer Advocate, will briefly discuss how an attorney can best make use of

the services offered by the Taxpayer Advocate Office.

HOT TOPICS

In addition to the foregoing, at our Quarterly Meeting we will have the opportunity to share current issues in our hot topics discussion.

I look forward to meeting with you again, and want to wish each of you a happy and prosperous New Year.

See you in Sacramento!!

Mike

MEETING INFORMATION

STATE BOARD OF EQUALIZATION
Board Hearing Room on First FL
450 N Street
Sacramento, CA 94279
916-445-2636
February 5, 2010 – 11:00 A.M.- 3:00 P.M.

MEETING AGENDA

1. Welcome 11:00 A.M.
2. Approval of November Committee Meeting Minutes.
3. California State Bar Annual Taxation Meeting Topics to be decided.
4. Election of 2nd Vice-Chair for 2010-2011 Terms
5. Comments for U.S. Tax Court
6. Quick Point in California Tax Lawyer & Pictures
7. Lunch
8. Speakers:
Bradley Heller, Tax Counsel III Legal Administration, Tax and Fee Division
Todd Gilman, Taxpayer Advocate
9. Hot Topic Discussions.
10. Adjourn 3:00 P.M.

SCHEDULE OF UPCOMING MEETINGS

May

5/7/10 Orange County (Lavar Taylor's office). Topic: Finding & Developing Abusive Tax Shelter Cases, Speaker: IRS Lead Develop Center.

August

8/6/10 San Francisco (Michelle Ferreira's office). Topic: Litigating a Tax Refund Suit in Superior Court against the FTB, Speaker: Marty Schainbaum & Deputy Attorney General.

The Annual Meeting of the Tax Bars is scheduled to be held November 4-6, Loew's Coronado

MINUTES OF THE NOVEMBER 13, 2009, COMMITTEE MEETING

Submitted by Michel R. Stein, Esq.

The November 13, 2010, meeting of the Tax Procedure & Litigation Committee of the Tax Section of the State Bar of California was held during the 2009 Annual Meeting of the California Tax Bar and California Tax Policy Conference at the Sheraton Harbor Island Hotel in San Diego, California. Present were the Chair, Michael Sanders, the Chair-Elect, Robert Horwitz, First-Vice Chair, Michel Stein and Second-Vice Chair David Klasing.

WELCOME AND INTRODUCTIONS

The Chair welcomed members to the meeting. The Chair also thanked Kornelia Davidson for her service as the outgoing Chair.

APPROVAL OF MINUTES

The first order of business was the approval of the minutes of the last meeting. The Chair indicated that the minutes of the last meeting were e-mailed to members of the Committee included as part of the Cal Tax Network newsletter. The Chair indicated that anyone who did not receive the e-mail, should contact him, so that his or her e-mail address could be added to the Committee list. The minutes were then approved.

APPROVAL OF THE FIRST AND SECOND VICE CHAIRS

During the July 31, 2009 meeting, Michel Stein was elected Second-Vice Chair. Due to the resignation of the First -Vice Chair, it was decided that Michel Stein would take over that position. David Klasing, the runner-up in the election for the Second-Vice Chair, accepted the vacated position of the Second-Vice Chair. The Chair asked those present at the meeting to approved the First and Second Vice-Chairs. These Officers were approved unanimously.

The Chair also thanked David Klasing for his hard work on the Cal Tax Network newsletter.

DISCUSSION TOPICS FOR WASHINGTON DELEGATION

Given the importance of Washington Delegation, the Chair decided to address topics for the Washington Delegation next. The Chair indicated that a list of topics (and authors who would be willing to draft the papers) for the Washington Delegation had to be provided to the Executive Committee by November 20, 2009. The Chair presented to the Committee for discussion the following topics that the Tax Court indicated that it would be interested in hearing:

1. *Innocent Spouse Relief Trial Issues*: Whether anything could be done better with respect to innocent spouse relief trial issues. Lavar Taylor expressed an interest in addressing this topic.
2. *Collection Due Process Cases*: Whether anything could be done better with respect to Collection Due Process cases. Woody Rowland expressed an interest in addressing this topic.
3. *Feedback on the Tax Courts New Electronic Filing System*: Comments or feedback on the upcoming Tax Court Electronic Filing System to be set in place in 2010. Stuart Hurwitz expressed an interest in addressing this topic.
4. *Technical Issues or Anomalies Relating to Tax Court Litigation*: The Chair asked whether anyone had an interest in providing suggestions for improvement with respect to Tax Court litigation. The Chair asked David Klasing whether he would be interested in addressing this topic. While at first, David had an interest, he preferred to address the Voluntary Disclosure topic that was discussed later on.
5. *Tax Court Rules Effective January 1, 2010, Comments on the new Tax Court Rules effective January 1, 2010, including rules limiting interrogatories to 25*: Jim Counts indicated that he heard from Tax Court Judge Vasquez that the interrogatory limitation rule might not be a hard or fast number. It was stated by a member that a Motion would be needed, however, to increase the number of interrogatories beyond 25.

Stuart Hurwitz indicated that he would be willing to contact LL.M. students to have them assist with this or other topics.

Other topics were suggested by the members of the Committee, which included:

1. [Innocent Spouse Relief Knowledge Threshold for Erroneous](#): Deductions v. Omitted Income Michelle Ferreira (in the name of Wendy Abkin) suggested a possible paper on the difference in the knowledge standards for innocent spouse relief cases when dealing with erroneous deductions versus omitted income.
2. [Interest Netting](#): Craig Houghton suggested a potential topic on issues pertaining to interest netting, where there is a deficiency in year one and an overpayment in year two. He indicated that he would e-mail the Chair details for his suggested topic.
3. [Gross Omission Statute of Limitations](#): Michelle Ferreira raised the potential topic of the Treasury Regulation pertaining to the 25% gross omission statute of limitations. Two cases were referenced – *Salman Ranch* and *Bakersfield Energy* – and Michelle and Robert Horowitz took issue with Regulation in light of these cases.
4. [Offer in Compromise](#): Lavar Taylor discussed a need for a better approach for the IRS to value closely held businesses for purposes an Offer in Compromise. Lavar indicated that the IRS had a mechanism in place to value Art, and something similar was needed for closely held businesses.
5. [Collection Due Process](#): Mark Erickson suggested a topic addressing the need for better taxpayer contact by the Revenue Officer before a Final Notice of Intent to Levy is issued. Woody Rowland expressed an interest in working on this topic. Mark suggested that the IRS have in place “some procedure to contact the taxpayer” before a Final Notice is issued.
6. [Voluntary Disclosure Issue](#): Dennis Brager raised the issue relating to the lack of discretion that Revenue Agents have with respect to those who have participated in the Voluntary Disclosure Program announced on March 23, 2009. Dennis expressed that the IRS Revenue Agents needs more discretion when considering the penalties in this case. David Klasing expressed a desire to work on this issue.
7. [Confidentiality of Information Pertaining to Tax Court Fillings](#): Craig Houghton expressed a desire to write on the topic of Tax Court confidentiality rules, and perhaps the need for procedures pertaining to filing information under seal.

QUARTERLY MEETINGS

The topic of quarterly meetings was discussed. While no specific dates for meetings were set, it was agreed that meetings for the Committee will be held in Sacramento, Orange County, and San Francisco. Michelle Ferreira indicated that her office could be used for a meeting in San Francisco. Lavar Taylor indicated that his office could be used for a meeting in Orange County. With respect to potential topics, one person suggested that the Trust Fund Recovery Penalty be a topic of discussion for an upcoming meeting. It was acknowledged that, once the dates are set, they will be announced to the Committee members.

HOT TOPICS

Members discussed the following topics:

- (1) Litigation involving the issue of statute of limitations for dual determinations in sales tax cases;
- (2) The right to a jury trial in State tax cases;
- (3) The possibility of new collection and audit program software for State taxing agencies; and
- (4) Better IRS collection standards for those falling into uncollectible status.

ADJOURNMENT

The Chair thanked those attending the meeting. There being no further business, the meeting was adjourned.

ARTICLES:

Virginia, There is Collection Due Process.

*By Woodford G. Rowland, Esq.**

Virginia O'Hanlon, a skeptical eight-year-old, wrote a letter to the editor of the New York Sun questioning the existence of Santa Claus. The editorial response was printed on September 21, 1897. Virginia was counseled to beware of skepticism because, yes, there is a Santa Claus, he exists as certainly as love and generosity and devotion exist.

A lawyer or a delinquent taxpayer might share Virginia's skepticism when considering whether Collection Due Process really exists. Taxpayer victories in IRS Collection Due Process cases in the Tax Court have not been frequent. There are many reasons for this, but the taxpayer's chances of success are limited by the relevant standard, abuse of

discretion. Sometimes it has seemed that the Commissioner's discretion has no bounds in collection matters. The Tax Court reviews the Appeals Office determination for abuse of discretion. An abuse of discretion occurs if the Appeals Office exercises its discretion "arbitrarily, capriciously, or without sound basis in fact or law." *Woodral v. Commissioner*, 112 T.C. 19 (1999).

[The Vinatieri opinion](#)

In the *Vinatieri* case (*Vinatieri v. Commissioner*, 133 T.C. ___, No. 16 (December 21, 2009)), the Tax Court judge made it clear that there is a line that the IRS may not cross. Specifically, an IRS levy may not cause economic hardship to a taxpayer, even if the taxpayer is not current in his or her return filing responsibilities. The case was decided by Judge Howard A. Dawson, Jr. who was appointed to the Court in 1962 and now serves on senior status.

In *Vinatieri*, the Service sent the taxpayer a notice of intent to levy to collect unpaid Federal income taxes for 2002, somewhere between \$5,000 and \$10,000. The taxpayer timely requested a hearing in the Appeals Office. She submitted to the settlement officer Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals, indicating she had monthly income of \$800 and expenses of \$800, had \$14 cash on hand, and owned a 1996 Toyota Corolla four-door sedan with 243,000 miles and a value of \$300. The Court determined that, if the taxpayer's wages are levied on she will be unable to pay her reasonable basic living expenses. If her car is levied on, she will be unable to work.

The Appeals officer stated in her log that the taxpayer meets the criteria to have her account reported as currently not collectible because of hardship in accordance with the Internal Revenue Manual (IRM). The Appeals Office, however, issued a notice of determination to proceed with levy, stating that the taxpayer was not entitled to collection alternatives because she had not filed her 2005 and 2007 Federal income tax returns. The taxpayer timely petitioned the Tax Court for review of that determination under section 6330(d), I.R.C. The Service filed a motion for summary judgment. The taxpayer, proceeding pro se, responded with a lengthy letter describing her dysfunctional marriage,

her extreme financial condition, and her health problems (pulmonary fibrosis) which made it impossible for her to work more than part-time. She also described her efforts to file her tax returns.

Under the regulations, the Secretary must release a levy upon all, or part of, a taxpayer's property or rights to property if, inter alia, the Secretary has determined that the levy is creating an economic hardship due to the financial condition of the taxpayer. Sec. 6343(a)(1)(D), I.R.C. The regulations provide that a levy is creating an economic hardship due to the financial condition of an individual taxpayer and must be released "if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses." *Treas. Reg. 301.6343-1(b)(4)*.¹ The determination of a reasonable amount for basic living expenses will vary according to the unique circumstances of the individual taxpayer. Unique circumstances, however, do not include the maintenance of an affluent or luxurious standard of living. *Treas. Reg. 301-6343-1(a)*.

The Court denied the government's summary judgment motion.

¹ The Regulations provide that, in determining a reasonable amount for basic living expenses the director will consider any information provided by the taxpayer including —

(A) The taxpayer's age, employment status and history, ability to earn, number of dependents, and status as a dependent of someone else;

(B) The amount reasonably necessary for food, clothing, housing (including utilities, home-owner insurance, home-owner dues, and the like), medical expenses (including health insurance), transportation, current tax payments (including federal, state, and local), alimony, child support, or other court-ordered payments, and expenses necessary to the taxpayer's production of income (such as dues for a trade union or professional organization, or child care payments which allow the taxpayer to be gainfully employed);

(C) The cost of living in the geographic area in which the taxpayer resides;

(D) The amount of property exempt from levy which is available to pay the taxpayer's expenses;

(E) Any extraordinary circumstances such as special education expenses, a medical catastrophe, or natural disaster; and

(F) Any other factor that the taxpayer claims bears on economic hardship and brings to the attention of the director.

Reg. 301.6343-1(b)(4)(ii).

The Court held that the statute and regulations require release of a levy that creates an economic hardship regardless of the taxpayer's noncompliance with filing required returns. § 6343(a)(1)(D), I.R.C., and Treas. Reg. 301.6343-1(b)(4).

The Court further held that a levy on the taxpayer's wages or car would cause the taxpayer to be unable to pay her reasonable basic living expenses, creating an economic hardship that would require release of the levy pursuant to section 6343(a)(1)(D), I.R.C., and Treas. Reg. 301.6343-1(b)(4).

Finally, the Court held that the motion for summary judgment should be denied because the government's determination to proceed with the levy was wrong as a matter of law and, therefore, was an abuse of discretion.

Impact of this case

Vinatieri essentially requires that the Appeals officer must make a determination that the levy will not create an economic hardship. The Appeals officer must verify that the requirements of applicable law and administrative procedure have been met, and whether any proposed collection action balances the need for the efficient collection of taxes with the taxpayer's legitimate concern that any collection action be no more intrusive than necessary. Sec. 6330(c)(2)(A). In *Vinatieri*, the judge determined that, when a taxpayer establishes that the proposed levy would create an economic hardship, it is unreasonable for the settlement officer to determine to proceed with the levy which section 6343(a)(1)(d) would require the IRS to immediately release. A determination to proceed with a levy that will cause economic hardship is wrong as a matter of law and, therefore, is an abuse of discretion.

This result applies equally to a collection officer's actions in the field. If a levy will cause economic hardship, the collection officer may not proceed. Under section 6343 and the supporting regulations, a levy that causes economic hardship must be released and should not be imposed in the first place, even if the taxpayer has failed to file one or more required returns. Collection officers frequently use the threat of a levy to spur the taxpayer to file delinquent returns. Under *Vinatieri*, the collection officer will

need to be careful that the threatened levy is not one that will cause economic hardship.²

The key to the *Vinatieri* case is the literal language of section 6343 and the supporting regulations. This language simply requires that a levy must be released if it creates an economic hardship. In contrast, the Internal Revenue Manual provides that a collection alternative (e.g., installment agreement, offer-in-compromise, currently not collectible status) will not be available if the taxpayer has failed to file a required tax return. The Court correctly declined to read these Internal Revenue Manual requirements into the statute. (The *Vinatieri* case will be surprising to many IRS agents in the field who view the Manual as the gospel.) Query whether the result in *Vinatieri* would be differ if the return filing requirement were to be incorporated into the regulations. Would the regulation be valid?

Likewise, the reasons for the non-filing may be important. In *Vinatieri*, the taxpayer was unable to obtain a copy of the W-2 for 2005 because the payroll company that had prepared it had gone out of business. The taxpayer claimed she had filed a late 2007 return but the settlement officer was unable to find a record of it. Neither the settlement officer or the judge criticized the taxpayer's efforts to file her returns, or described her efforts as lacking in good faith.

On the other hand, the regulations impose a good faith requirement in Reg. 301.6343-1 (b)(4)(iii), as follows:

(iii) Good faith requirement. In addition, in order to obtain a release of a levy under this subparagraph, the taxpayer must act in good faith. Examples of failure to act in good faith include, but are not limited to, falsifying financial information, inflating actual expenses or costs, or failing to make full disclosure of assets.

A tax protestor who refused to file returns based on

² The Regulations provide that a taxpayer may inform the Service that a levy is creating economic hardship and request that the levy be released. Reg. 301.6343-1(c). However, the Regulations also make it clear that, even if the taxpayer does not request a release, if the Service determines that a levy is creating an economic hardship, the levy must be released and the taxpayer must be promptly notified. Reg. 301.6343-1(a).

frivolous grounds might well fail this test. A taxpayer who is grossly negligent in failing to file required returns would present an interesting case.

It is noteworthy that this result was achieved by a pro se taxpayer. The taxpayer's written response, quoted at length in the opinion, would tug at the heartstrings of anyone (except, obviously, the Commissioner of Internal Revenue). However, the taxpayer did not set forth a legal argument or any legal analysis. It would have been easy for the Court to grant the government's motion, or to dismiss the case for failure to properly prosecute. However, it appears that Judge Dawson concluded that the tax law and the collection due process scheme surely cannot condone a levy on a taxpayer in such sadly compelling circumstances, and who would sustain extreme hardship as a result of the levy. Judge Dawson dug in, did the work, and found the legal support for the laudable result.

So, Virginia, is there Collection Due Process? It would be an overstatement to say, without qualification, yes. However, the Vinatieri decision should increase public confidence that the Collection Due Process procedures, buttressed by Tax Court review, are effective safeguards against unduly harsh collection activity.

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Changes in FOIA

*By Jim Counts CPA CTFA
Hemet CA*

The IRS announced they are changing the processing of Freedom of Information Act (FOIA) and Privacy Act requests.

The Office of Disclosure processes FOIA and Privacy Act requests for tax information. Disclosure will begin using a new software imaging application that will:

- Centralize receipt and control of requests
- Allow more efficient processing of requests
- Allow even distribution of FOIA requests throughout the country

The implementation of this automated processing, called AFOIA. The IRS will begin to phase in the use of the new software starting with the western part of the country. Effective January 11, 2010, requests previously sent to Western Area Disclosure Offices in Alaska, California, Hawaii, Idaho, Nevada, Oregon, Utah or Washington, should go to:

Internal Revenue Service
Disclosure Scanning Operation
2385 Chamblee Tucker Road
Stop 93A
Chamblee GA 30341

The remaining states will phase into AFOIA according to the schedule in the attachment. Please continue sending requests for records in these remaining states to the local Disclosure Office until the scheduled implementation date for those areas.

From January 25, to February 5, 2010, Western Area Disclosure employees will be transitioning to the new software and there will be brief periods of unavailability. For urgent Disclosure matters during this time, please contact the local Stakeholder Liaison office for routing of your request.

Let's Play Ball with IRS C.I. Versus the Ninth Circuit Decision

By Edward (Ed) Rodriguez, CAMS, CFS, EA

It is hard to believe that an electronic records case, which has created controversy and new case law, was initiated by IRS Criminal Investigation (CI). *United States v. Comprehensive Drug Testing, Inc.*, 579 F.3d 989 (9th Cir. 2009) (CDT) will potentially change the legal landscape not just as to how the IRS CI searches for electronic records, but for every law enforcement agency in the 21st Century.

The Ninth Circuit issued an opinion in the CDT case whereby all search warrants for electronic documents cannot rely on the "plain view doctrine"³ to expand the government's investigation to other individuals. Furthermore, the CDT case establishes procedures on how the government must seize information on

³ *Arizona v. Hicks*, 480 United States Supreme Court 321 (1987)

computers.⁴ IRS CI and all federal law enforcement agencies will need to change their investigative manuals regarding protocols on how the case agent and electronic seizing agent will need to interact in future execution of search warrants for electronic files.

History:

In 2004, ten Major League Baseball Players were suspected of receiving (and using) steroids purchased from Bay Area Lab Cooperative (BALCO). On January 16, 2004, the government served a subpoena on CDT's lab records for every Major League Baseball Player tested for steroids even though the government suspected only ten players. The Players Association and CDT were concerned that the government subpoena would invade the players' privacy rights and they decided to try to negotiate with the government. The Players Association and CDT prepared a "White Paper" explaining the serious constitutional privacy concerns that the subpoena raised.

On March 3, 2004, the government issued a second subpoena to CDT seeking records on only eleven Major League Baseball players. In addition, it refused to withdraw the first subpoena that had been issued on January 16. On April 7, 2004, the Players Association and CDT filed a motion to quash the subpoena in the Northern District of California. When the government learned that CDT and the Players Association were moving to quash the subpoenas, the government decided to take a more aggressive approach and execute a search warrant.

The application for a search warrant requested information to link the steroids test results to only the ten individual Major League Baseball players. However, during the execution of the search warrant, IRS CI's electronic agents seized the entire hard drives and copied all the computer data from CDT's computers. Now that the government had all the electronic evidence, they proceeded to review the entire database, which resulted in IRS CI and DOJ expanding their investigation to other players not previously mentioned in the search warrant.

⁴ United States v. Comprehensive Drug Testing, Inc., Filed August 26, 2009 (in the 9th Circuit Court of Appeals – Final Opinion) Page 11892.

When IRS CI and DOJ presented the warrant application to the magistrate judge, CDT claimed that the government failed to inform the magistrate that it previously issued a subpoena for those same records. The search warrants are investigative tools of the federal government and can be used without informing the federal witnesses, persons of interest, or defense lawyers.

After these records were obtained by the government, a motion under Rule 41(g) for return of the property was filed in the Central District Court of California by CDT. The Court decided that the government had not complied with the search warrant procedures in executing its warrant at CDT. In addition, other search warrants were executed in Nevada. The District Court granted the motions, which netted the same result.⁵ The government was ordered to either destroy or return all records except the seized records of the ten identified ballplayers. In Nevada, the court ordered that all traces from the improper seizures in the government's possession be destroyed or returned.⁶

A grand jury subpoena from the Northern District of California also was quashed. The courts refused to accept the government's argument that it had the right to obtain all of the computer records due to the "plain view doctrine" or that it was otherwise allowed to retain evidence from the searches.

In CDT, the Ninth Circuit agreed with all three district court orders.⁷ The Ninth Circuit also provided additional directions regarding future court-ordered search warrants of computers and electronic stored information (ESI). These directions included that segregation of computer data or files must be done by a "screen team" whereby they can review the records relating only to the warrant and return the remaining information without tainting the case agent on the

⁵ United States v. Comprehensive Drug Testing, Inc., Filed February 12, 2007 (Petition for Rehearing and Rehearing *En Banc* in the 9th Circuit Court of Appeals)

⁶ Major League Baseball Players Association v United States District Court of Appeals for the District of Nevada, Filed August 26, 2009 (No. 05-15006 D.C. NO. CV-04-00707-JCM) page 11881.

⁷ United States v. Comprehensive Drug Testing, Inc., Filed March 21, 2007 (Government's Opposition to Appellees' Petition for Rehearing and Rehearing *En Banc* in the 9th Circuit Court of Appeals)

investigation. Also, the government must destroy (if the material is otherwise illegal to possess) or return all non-responsive data.

Even if the government had violated the plaintiffs' Fourth Amendment rights, the remedy for the alleged violation imposed by the Nevada District Court and upheld by the majority is both unprecedented and in conflict with the past several decades of the Supreme Court's Fourth Amendment jurisprudence. Although a party can seek the return of property under Rule 41(g), and the exclusionary rule may prevent illegally seized evidence from being used for particular purposes during criminal proceedings, ordering the government to erase all the information it obtained from a search or seizure of property is not consistent with the limited scope of the modern exclusionary rule.⁸

[The En Banc Ruling:](#)

Because the Ninth Circuit upheld all three district courts sitting en banc, it has changed the legal landscape in which the government must obtain all electronic evidence.

First of all, when the government submits a warrant to the magistrate judge, it must first waive reliance upon the "plain view doctrine."

Second, a segregation and redaction must be performed by an independent party, separate and apart from the agent and prosecutor involved in the actual investigation.

Third, all warrants and subpoenas issued must also articulate to the magistrate judge the actual risks of destruction of information before it is executed.

Fourth, the government search mechanism for computer data must focus only on the computer data information to which probable cause has been applied.

Lastly, the government must destroy or return all information not pertaining to the

investigation or not covered under probable cause and keep the magistrate judge informed of that process.

These procedural safeguards that the government must now follow will have a long lasting impact on the way IRS CI will be obtaining electronic evidence moving forward. Therefore, any defense attorney involved with an electronic stored data investigation would benefit greatly by hiring a former investigator to question and conduct skillful due diligence when reviewing these records and court procedures that law enforcement agents must now follow.

It's possible that the Supreme Court will hear this case and make a final decision on how the federal government can proceed in obtaining electronic documentation. For now, the Ninth Circuit opinion changes the way IRS agents can conduct electronic search warrants or, for that matter, financial searches.

An agent cannot seize records simply because they happen to reside in the same filing cabinet or database file. The records must now be specially mentioned in a warrant relating to the target of the investigation. Agents evidently will be scrutinized thoroughly by their in-house counsel before any warrant is submitted by a prosecutor.

Edward (Ed) Rodriguez, CAMS, CFS, EA, joined Watkins Meegan LLC as a manager in its Forensic Accounting and Litigation Support Group in 2009. Ed has more than 25 years of experience in forensic accounting audits and investigations, specifically money laundering, criminal tax matters, and financial crimes analysis. Prior to joining Watkins Meegan, he served as a Special Agent-Senior Analyst in the Financial Crimes Section of the Internal Revenue Service Criminal Investigation, from which he retired.

Changes to Federal Estate Tax, Gift Tax, and GST Tax Laws.

Excerpts from Outline by Michael J. Vollmer, Esq.

Editor Note: Mr. Vollmer was kind enough to grant the editor permission to cherry pick items of interest to our committee for publication in this newsletter from his presentation outline entitled, "Legislative Updates and Recent Developments" presented to the Orange County Bar Association Trusts and Estates Section January 2010 Meeting.

1. Status (as of this outline date of 1/5/2010):

⁸ Major League Baseball Players Association v United States District Court of Appeals for the District of Nevada, Filed August 26, 2009 (No. 05-15006 D.C. NO. CV-04-00707-JCM) page 11883.

a. If Congress takes no action (to "repeal the repeal" or make other provisions), then effective 1/1/2010 there is no federal estate tax (FET) or generation skipping transfer (GST) tax; there is still a federal gift tax (FGT) with a \$1,000,000 exemption and a flat 35% gift tax rate above that exemption; the "step-up in income tax basis" rules are replaced with somewhat complicated "carryover basis" rules; and transfers to non-grantor trusts will be treated as taxable gifts [IRC 2511(c)]. Thereafter on 1/1/2011 the older FET, GST and FGT rules are reinstated (\$1,000,000 FET exemption with 55% top tax bracket; \$1,000,000 plus CPI GST Exemption; \$1,000,000 FGT exemption; and a 100% state death tax credit, which could be a boon to California).

b. On December 3, 2009 the House passed a permanent extension of the FET (\$3,500,000 exemption and 45% flat rate) [see HR 4154, Permanent Estate Tax Relief for Families, Farmers and Small Business Act of 2009], but the Senate was deadlocked and nothing has passed to date. The Joint Committee on Taxation estimates this bill will cost 233 billion dollars over ten years (HR 4154 contains an exception to the "pay-as-you-go" house rules).

c. There are a number of possible options, including:

(1) A one year extension of 2009 rules (most likely) - \$3,500,000 FET exemption with a 45% flat rate; a \$1,000,000 FGT exemption with a 45% flat rate; a \$3,500,000 GST exemption with a 45% flat rate; and "step-up" rather than "carry-over" income tax basis.

(2) A two year extension (less likely).

(3) A permanent extension, with an index for inflation (possible - and supported by Sen. Baucus of MT and Sen. Conrad of ND).

(4) A \$5,000,000 PET exemption and a 35% flat rate (Sen. Kyle of AZ and Sen. Lincoln of AR). Not very likely, especially since HR 3905 Estate Tax Relief Act of 2009 was blocked by the House Rules Committee by a vote of 7-1; however, all Republican senators may be able to force this "compromise".

(5) A \$2,000,000 exemption indexed for inflation (Sen. McDermott of WA - not likely).

(6) "Portability" of the FET exemption between spouses (surviving spouse can use a predeceased spouse's unused exemption) [SB 722 by Sen. Baucus of MT]. Practice note: it may be better not to rely on portability, because assets may increase in value between the two deaths, and portability does not apply for GST purposes.

(7) "Reunification" of FET and FGT (same exemptions and rates - makes life easier, but this is a revenue loser for the government and does not meet current "pay-as-you-go" plans).

(8) "IRC 2704 valuation discount" reform (or elimination of discounts if property passes to family members) – see:

5/11/2009 Treasury Department Green Book recommendations

www.tax.cchgroup.com/PDFs/Tax-Brief-GreenBook-05-14-09.pdf].

(9) Minimum ten year GRAT terms (see Green Book).

(10) Consistency in values for FET and income tax basis purposes (and disclosure to IRS even if there is no requirement of FET returns being filed) - see Green Book. In 2011 stock brokers may have to disclose basis information (so be certain they have date of death values).

d. Retroactive application is likely constitutional. There is an ongoing argument about whether retroactive application of any legislative solution is constitutional, and we can count on protracted litigation. See, however, *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L.Ed.2d 22 (1994) where retroactive application of changes to IRC 2057 was declared constitutional, and where the Supreme Court opinion stated: "This Court repeatedly has upheld retroactive tax legislation against a due process challenge. See, e.g., *United States v. Hemme*, 476 U.S. 558, 106 S.Ct. 2071, 90 L.Ed.2d 538 (1986); *United States v. Darusmont*, 449 U.S. 292, 101 S.Ct. 549, 66 L.Ed.2d 513 (1981); *Welch v. Henry*, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87 (1938); *United States v. Hudson*, 299 U.S. 498, 57 S.Ct. 309, 81 L.Ed. 370 (1937); *Milliken v. United States*, 283 U.S. 15, 51 S.Ct. 324, 75 L.Ed. 809 (1931); *Cooper v. United States*, 280 U.S. 409, 50 S.Ct. 164, 74 L.Ed. 516 (1930)."

e. Modified carry-over basis rules (federal law only).

(1) Do you remember the "carry-over basis" rules of 1976 (which were repealed retroactively in 1978)? For listed securities, at least they allowed us a "fresh-start" of 12/31/1976 stock values, which were readily ascertainable.

(2) 2010 income tax basis rules (IRC 1022) for property acquired from a decedent:

(A) Basis is lesser of decedent's adjusted basis or fair market value (FMV) at death, with adjustments in paragraphs B, C, and D (but never more than FMV at date of death).

(B) \$1,300,000 (plus inflation, using 2009 as the base year) aggregate basis increase for property passing to beneficiaries and heirs [but only \$60,000 for decedent non-resident non-citizen].

(1) Result: small estates (but over \$1,300,000) passing to children would have no estate tax, but could incur substantial capital gains taxes when the assets are later sold (especially if the capital gains rate is increased to 20% in 2011, or higher rate later).

(2) Estimated "numerical impact" (by Rep Pomeroy of ND): about 6,000 estates would be subject to estate tax with a \$3,500,000 exemption, but 61,000 would have over \$1,300,000 increases in value and be subject to income tax on subsequent sales.

(C) Additional \$3,000,000 (plus inflation) "qualified spousal property" basis increase (outright to spouse; or to QTIP Trust - probably including a "life estate plus power of appointment" trust if it is QTIPable, but not an estate trust). No increase for property at surviving spouse's death under a power of appointment. 100% of the community property is available for one total \$3,000,000 increase, which can be applied to either the decedent's 50% interest, or the surviving spouse's 50% interest, or both; however, joint tenancies only get decedent's 50% step-up [IRC 2040].

(D) Sum of various capital loss carry-overs, operating loss carryovers, and certain IRC 165 losses affect the computation. Therefore, some sales immediately prior to death might be advantageous. And just imagine the problems inherent when there

are "negative basis" assets (where the outstanding liabilities exceed the basis).

(3) Who allocates? Executor [and if no executor is appointed, probably a trustee or other "statutory executor"] is required to make the basis allocations [IRC 6018]. Watch out for problems such as: (A) co-executors who cannot agree; (B) executor's fiduciary duty to beneficiaries and conflicts of interest (especially when basis adjustment increase passes partially or wholly to the executor as beneficiary); (C) clauses in Wills or trusts which exonerate the executor from liability; (D) directions in Wills or trusts on how to allocate to adjustment; (E) loss of full basis adjustment if IRS successfully argues that assets were overvalued; (F) executor needing to consider income tax brackets of beneficiaries, and which assets are likely to be sold in the near future; and (F) requests for court approval of allocations.

(4) At surviving spouse's death, QTIP trust assets do not receive a new income tax basis because the QTIP trust property was not "owned by the surviving spouse".

(5) "Death bed" transfers do not get step-up in basis at decedent-donee's death unless transfer occurred at least three years before decedent's death (note that this may not apply to some transfers between spouses).

(6) Practice note: the above factors illustrate why clients have to keep exceptionally good records - especially since we do not have the 1976 "fresh start" rules!

(7) With a couple having \$5,600,000 in potentially available basis adjustments (\$3,000,000 plus \$1,300,000 at the first death, and another \$1,300,000 at the second death), it will be important to discuss vehicles to assure that there are at least \$4,300,000 in assets at the first spouse's death to utilize the available basis increases. Practice note: perhaps we have a new need to consider aggregate community property agreements.

(8) The IRS and the taxpayer may now reverse their traditional positions. The IRS may argue for low values or large discounts, and the taxpayer may want high values and low discounts (especially if the FMV at death is otherwise lower than the basis).

(9) Reporting requirements relating to income tax basis:

(A) Lifetime gifts: on Form 709; also to be given to beneficiary within 30 days following the filing of the 709 [IRC 6019(b)].

(B) Transfers at Death [new IRC 6018]: (1) transfers of non-cash assets in excess of \$1,300,000; and (2) appreciated property received by a decedent within three years of death that does not qualify for basis adjustments [IRC 1022(d)(1)(C)], including all basis and date of death information, and the allocation of new carry-over basis adjustments. This information is to be supplied with the decedent's final income tax return, and must also be supplied to beneficiaries. Penalty for failing to report to IRS is \$10,000 [IRC 6018], and if determined to have been intentional, 5% of the FMV of the property (at the date of the decedent's death) for which the report is required.

2. Drafting Protective Amendments/Codicils.

a. Do our existing funding clauses mean anything? Existing clauses may be meaningless because they refer to concepts that no longer exist (such as the marital deduction, estate tax, taxable estate, unified credit, exemption equivalent, or GST exemption). And without estate tax implications, what do our clients intend?

(1) Problems: With no estate tax, an existing formula may mean that 100% of the decedent's estate goes to the "exempt" portion (which may or may not have provisions for a surviving spouse); or perhaps it all passes to the "survivor's" portion.

(2) Traditional family solutions:

(A) One possible solution for a "traditional" non-blended family may be to provide for outright distribution to the surviving spouse, with flexible disclaimer provisions [see the Christiansen and Petter cases below for the concept of a "defined value" disclaimer].

(B) Or perhaps everything should fund a QTIP Trust (so you would retain the \$3,000,000 carry-over basis increase, and the assets would not be included in the surviving spouse's estate). A modification of this might be to provide that to the extent a QTIP election is not made for any portion, then that non-elected portion would fund a "By-Pass Trust". Procedural thought: how and when do you make a QTIP election if no 706 is required?

(C) Another solution might be to have all of a decedent's interest in assets pass to an irrevocable "decedent's trust" where the surviving spouse has income rights, and perhaps rights to principal under an ascertainable standard, and perhaps even a limited power of appointment over principal at death (just like many present "by-pass" or "exemption" trusts).

(D) Another solution might utilize a QTIP Trust for assets selected by the Executor/Trustee to qualify for the \$3,000,000 carry-over basis increase.

(3) Blended family solutions. What happens if there are blended families? Perhaps all of the deceased spouse's assets should be held in that decedent's "By-Pass Trust", perhaps modified to provide for net income rights to the spouse during the spouse's lifetime (perhaps in a QTIP format to achieve the \$3,000,000 "carry-over basis" increase advantages); or perhaps nothing should pass to the surviving spouse, or it should remain a "sprinkling trust" (in which event only a \$1,300,000 carry-over basis increase would be available, and the \$3,000,000 spousal basis adjustment would be lost).

(4) The amendment/codicil solution. How do you fix the problem on a short term basis? Perhaps by a "short" amendment or codicil that provides that "if I die at a time when the FET and GST do not apply to my estate, then all of my interest in trust assets will be held, managed and distributed on the terms specified in the [By-Pass Trust] [Survivor's Trust]." Additional language might also be added to deal with carry-over basis issues, and either specify how the basis increases are to be allocated, or at least exculpate the Executor/Trustee for making allocations. If the estate tax becomes applicable again in its 2009 form, then the amendment or codicil could be revoked, and the carefully drafted existing documents will again be applicable.

(5) What if there are assets in states that have an inheritance tax or equivalent?

(6) Will states (like California) enact "savings" provisions like those presently existing for marital deduction and charitable provisions (PC 21500, and 21540)? If so, it would have to be emergency legislation, and who would the legislature make the favored party (spouse? children?).

b. Carryover Basis. Draft to specifically allocate; or confirm that the Executor/Trustee has the authority to allocate carry-over basis increases; or expressly permit allocations to non-probate assets and on a non-pro rata basis; or perhaps even to permit allocations of the carry-over basis increase to assets that the Executor inherits, and to release the Executor from liability for doing so.

c. Gifting possibilities now (and attendant risks)?

(1) Gifts to grandchildren or long-term trusts when there is no GST (danger: retroactivity). Might a "defined value" gift be appropriate?

(2) Gifts now where discounts may still be available (hopefully any IRC 2704 discount limitation or elimination statutes would not be retroactive).

(3) Gifts now while there is only a 35% FGT rate (danger: retroactivity).

NOTES FROM THE EDITOR

Articles and comments for the next newsletter are requested and are being actively solicited.

If you have material that would be informative and relevant to the members of the Tax Procedure and Litigation Committee, please contact me at my office at 949-681-3502, or at dave@taxesqcpa.net.

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