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TAXATION SECTION

October 2012

It has been my honor to serve as Chairperson of the Taxation Section Council for the fiscal year ending September 30, 2012, and I'm pleased to report that thanks to the hard work of the Council, the Section continues to admirably serve Michigan tax practitioners and the citizens of our state. I'd like to briefly report on the good work that has been done this year.

Mission of the Section. The Section has two constituencies: the attorneys in our section, and the public. We serve these constituencies through education and by providing leadership towards an equitable, efficient and workable tax system. These two components frequently work together and overlap, and this year saw them converge in many ways.

Member Services. The value we add to our members' tax practice experience is first and foremost in our mission, so I will focus first on the educational and networking services we provided over the past year.

25th Annual Tax Conference. This year marked the 25th year of our annual conference, and we had an excellent program and a significant increase in registration, attendance, and sponsorships. I remember too well the debates from my early years on the Council about possibly discontinuing this event after enthusiasm waned for the format and constantly changing location. Thanks to the change in format and consistent quality programming, this is now one of the most valuable services we provide to our membership. The 2012 Conference was particularly successful thanks to the extraordinary and thoughtful leadership shown by Michael Antovski, with the assistance of ICLE's Jeff Kirkey and his staff, and our Program Facilitator, Erin Sexton. Alex Domenicucci, who will chair the 2013 Conference, has been hard at work with the planning, as the Committee Chairs are well aware.

Committees. Maybe I'm biased, having come to Council through my involvement in the Employee Benefits Committee, but I have always been convinced that the Section's Committees are truly the lifeblood of this Section. The education and dialogue they provide to the members are invaluable.

This year was unusual because of the high turnover in our Committee chair positions, but I'm pleased to report that the rookies delivered - we had a robust schedule of Committee activities this year. Much of the Committee activity focused on the outstanding Committee breakout sessions that were part of the Annual Tax Conference. In addition, each of the committees had separate or joint programs for their members. Three new committee chairs planned and executed two or more additional substantive meetings for their committees: Deborah Baughman brought in two national level speakers for the Employee Benefits Committee, Frank Henke and the Estates and Trusts Committee had two well-attended meetings on gift tax and cross-border estate planning, and James Combs organized meetings for the Business Entities Committee relating to Section 382 and hedge fund taxation issues. Jackie Cook carried on the strong tradition of maintaining an active schedule for the State and Local Tax Committee, including two networking events and the annual Tax Tribunal luncheon. Andy Lane continued his good work for the International Tax Committee. In addition to a lot of work getting Nina Olsen, the National Taxpayer Advocate, to speak at the Annual Tax Conference, Nicole Appleberry of the Practice and Procedure Committee collaborated on two other events and is working on an upcoming program regarding Michigan tax enforcement issues.

But perhaps the most exciting Committee development this year was the creation of a new Committee, the Young Tax Lawyers Committee, which was created largely through the efforts of Stephanie Teitsma. The topic first came to my attention exactly one year ago, at the Annual Meeting Dinner, when Dan Houlf introduced me to Stephanie and she discussed the possibility. A formal proposal followed, the Committee was formed, and Stephanie had her first meeting in early April, with presentations by three successful young tax lawyers on their career paths. She is now planning an ambitious seminar on clear legal writing, which we expect to be well-attended by young and not-so-young tax lawyers alike.

This initiative has incredible potential to attract younger lawyers to our specialty and provide them with coaching resources from the Section at large.

Outreach and Tax Court Luncheons. And speaking of Dan Houlf, I can't help but segue at this point to my thanks and praise for the incredible efforts by Dan this year. Dan's responsibilities have included our outreach function in recent years and he has performed tirelessly and admirably in reaching out to tax law students and young tax lawyers. In lieu of a Tax Court Luncheon last fall, Dan was the primary organizer of an excellent program on Best Practices before the IRS Appeals Division, bringing together multi-disciplinary practitioners and IRS Appeals Division officers for a full morning at Wayne State. He also managed to drum up approximately 100 student scholarships for the Michigan Tax Conference and planned and executed a Tax Court Luncheon with Judge Dean in April. The Section owes him great thanks for planting seeds for our future successors.

ICLE After Hours Tax Series. Our collaboration with ICLE on the After Hours Tax Series continued this year and is about to be underway again. We had a successful series of programs, and continued to expand the delivery of these programs by webcast, with less reliance on on-site presentation attendance. Jeff Kirkey of ICLE played a major role in this, as well as being instrumental as our partner in producing the Annual Tax Conference.

Michigan Tax Lawyer. This is the third issue of the Section's journal, the *Michigan Tax Lawyer,* released this year. I want to thank Marla Carew for all of her hard work as Editor. This is one of the most demanding jobs on the Council, and carries great responsibility. Somehow the image of herding cats comes to mind. The result is a highly respected journal unlike any other tax section publication in the country, and Marla has done an admirable job over her editorial career.

Internet and Bar Journal Liaison. Last but not least are two other services we provide to our members. Thanks go to George Cassar, who has been responsible for planning our Annual Meeting and managing our internet presence over the last year, with assistance from Erin Sexton, the Program Facilitator. The Young Tax Lawyers Committee will become more involved in the social media aspects of our internet presence in the future.

Thanks also to Gary Glenn who has acted as our liaison with the *Michigan Bar Journal* this year. This year also marked the publication of a theme issue featuring articles by Taxation Section members, which were arranged and coordinated by Judge Paul McCord prior to his elevation to the Tax Tribunal bench.

Liaisons. We have four liaisons who keep us apprised of developments in other organizations. First, Rob Heitmeyer and Eric Skinner are our liaisons with the Office of IRS District Counsel. They have been very diligent and thoughtful about attending our meetings and keeping us informed of developments in IRS enforcement. They also have been instrumental in assisting with programming for the Section membership whenever their office can play a role. Fred Hoops acts as a go-between for our Section and the Probate & Estate Planning Section. Brian Einhorn was our liaison with the State Bar Commissioner, and helped renew our relationship with the State Bar this year. And Phil Admiraal is our liaison with the Young Lawyers Section.

And now I'd like to turn to our public service activities.

Public Service

***Pro Bono* Outreach and Low Income Taxpayer Clinic Grant Program.** Gary Glenn also headed the Low Income Taxpayer Clinic Grant Committee, which awarded $9,000 in grant funding to *pro bono* taxpayer assistance programs across the state, many of which are affiliated with Michigan law schools. Paul McCord has continued his work from the previous year on the implementation phase of the Section's *pro bono* initiative, trying to iron out the process for eligibility, case intake and case assignment and management. When it is up and running, this program will match Section members with clients in need of *pro bono* tax representation.

Public Policy Development. Carolee Kvoriak Cameron was quite busy this year as the Council's Federal and State Legislation/Public Policy Liaison, with help from the *ad hoc* committee of state and local practitioners that have been so helpful with thoughtfully analyzing new issues that arise. Within the first few weeks of the year, we provided input on pending legislation regarding CIT apportionment issues. We also developed new Section Public Policy Position statements opposing retroactive tax legislation and third party contingent fee audits, and Carolee was responsible for managing the process of creating and formally adopting those policies. Finally, we assisted the State Bar of Michigan by helping it clarify its *Member Advisory* bulletin to State Bar members regarding Michigan Department of Treasury unclaimed property act enforcement initiatives.

The year also saw new introduction of two new bills relating to a cause near and dear to the Section, the possible enactment of offer in compromise legislation. The Section has had a formal policy supporting such legislation since October of 2005, which was spearheaded by Wayne Roberts, the incoming Chairperson. The Council is hopeful that action might finally be taken on these or similar bills to provide much-needed relief in line with the federal model for fresh starts in appropriate situations.

A lot of work goes into delivering the services that the Council provides to the Section and the public. In addition to all of the individuals I already have mentioned, the Council could not function without the sincere and conscientious efforts of the officers. I must start by thanking Gina Torielli, my predecessor as Chairperson of the Council. I have followed Gina throughout my time on the Council, first as chair of the Annual Tax Conference and then through the officer chairs, and I could not have asked for a better example or mentor along the way. If I only had asked myself, "What would Gina do?" more often, I know I would have come closer to achieving my hopes for this year. As she steps away from Council this year, we are losing a valuable asset, but we can rest easy knowing that she's not that far away and always willing to help.

I am especially encouraged by the fact that Wayne Roberts is taking the reins of leadership for the Council. He has helped me tremendously this year with many suggestions, and I know he has a clear vision of the Section's future. Wayne is a lawyer of the highest integrity and competence, sincere and professional to the core, and I have no doubt that he will lead the Section thoughtfully to new levels of excellence.

Lynn Gandhi has done a great job of keeping track of the money, and as usual, just when you have figured out how to reconcile our books with the State Bar's we hand the job off to someone else. Marjorie Gell is that lucky person, having completed her year as Secretary. All of the officers have provided me with valuable counsel, coaching and nudging when I needed it, and I thank them for their honesty, wisdom and patience.

I must give special thanks to Erin Sexton, the Section's Program Facilitator. By day, Erin works in my Ann Arbor law firm. Early in her career I drafted her into supporting my volunteer activities for the Section. As a result, she has provided me with support in every job I have had for the Section and the Council over the last nine years. Over that time she also has worked her way up to office manager of our firm, and last year she took over the job of Program Facilitator for the Council. She carries a lot of behind the scenes responsibility, and I tend to take that for granted. If something got done this year, you can be sure that Erin had something to do with it. If it did not get done, you can be sure that it never was assigned to her, which means only I am to blame. I think she did a great job and will do even better now that she has her first year under her belt, and especially because she can look forward to the future guidance of some of the best leaders Michigan tax practice has to offer.

Finally, thanks to all of you, the Section membership, for your continued participation in our Section. I look forward to the contributions we all can make to each other and to the Michigan citizenry as we continue to work toward an equitable, efficient and workable tax system.

Sincerely,

Warren J. Widmayer
2011-2012 Taxation Section Chair

REPORT OF THE BUSINESS ENTITIES COMMITTEE

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The Business Entities Committee is planning a presentation this Fall on the topic of purchase price allocations in mergers and acquisitions. The date and location of the presentation will be announced once details are finalized.

REPORT OF THE ESTATES & TRUSTS COMMITTEE

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The Estates and Trusts Committee will be holding an event in the area of "Asset Protection and Underlying Tax Aspects" in late January. Exact date, time and location will be announced as soon as available.

REPORT OF THE INTERNATIONAL TAX COMMITTEE

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The International Tax Committee is proud to announce that it has a new committee chair, Hassan Jaafar. Hassan is part of PwC's Detroit tax practice and is a graduate of the University of Detroit's School of Law where he earned his JD and The Georgetown Law Center where he earned his LLM in taxation. Also, the committee has secured Jarrod Wood of PwC as its speaker for the State Bar of Michigan's Annual Tax Conference in May of 2013.

REPORT OF THE PRACTICE & PROCEDURES COMMITTEE

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The Practice & Procedure Committee is working with the Michigan Department of Treasury on an event that will provide helpful information on resolving state tax controversies. More details to be announced as they develop.

REPORT OF THE STATE & LOCAL TAX COMMITTEE

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The State Bar of Michigan - Taxation Section's State and Local Tax Committee (SALT) held its annual reception August 23, 2012 at the Lansing office of Dykema Gossett, PLLC. SALT committee members were joined by approximately 40 attendees including representatives from the Michigan Department of Treasury, the Michigan Attorney General's office, the Michigan Tax Tribunal, State Government, and the Michigan Court of Claims. The annual reception has become an important social event for the Taxation Section. This event allows Section members and government officials to engage in informal discussions and socialize in a relaxed environment.

THE SUPREME COURT'S OBAMA-CARE DECISION: THREE IRONIES AND FIVE RARELY-REMEMBERED LAWS

By Michael R. Shpiece

Assuming that you haven't been dead for the past five months, you probably already know the basics of the US Supreme Court's decision on the constitutionality of the "Affordable Care Act" or "Obama-care." (And if you were dead, you probably aren't reading this article anyway.) So rather than simply rehashing the holdings, I thought I would take this opportunity to talk about the decision in terms of its ironies and a reminder of some laws (obscure and otherwise) that many of us forgot or never learned. This is not intended to be a comprehensive discussion of the jurisprudence of those old laws; rather, I mean to alert you to them and explain how the Court dealt with them in this case.[1]

Background

In 2010, Congress passed, and President Obama signed, comprehensive federal health care reform, the Accountable Care Act ("ACA").[2] Although much of the public attention has been focused on only a few provisions (such as the "individual mandate"), the ACA contains hundreds of provisions designed to increase the number of Americans covered by health insurance or similar programs,[3] improve the scope of the benefits provided by those programs,[4] increase the availability of health services and providers,[5] decrease the amount of money that health care is costing the country as a whole,[6] and improve the quality of the health care that is being provided.[7] Of course, there was need to pay for some of these changes, and Title IX included several revenue raisers."[8] Finally, it seemed to some to be a good time to adopt a few other laws.[9]

My point with all of this is (1) there is a lot more to this law than what was challenged in the Supreme Court; and (2) whether you believed it would be successful or not, it was a multi-faceted attempt at using several ways to solve the large health care problem.

Almost as soon as it was signed, the ACA was challenged as unconstitutional in courts throughout the country. The 6th, DC, and 11th Circuit issued differing opinions, and the US Supreme Court granted cert to review the 11th Circuit's decision on November 14, 2011. In its grant of cert, the Court focused its attention on the constitutionality of only two ACA provisions: the "individual mandate" and the Medicaid expansion.[10]

The Court scheduled an unprecedented three days/6 hours of oral argument (oral argument is usually limited to 1 hour per case) and on its own appointed two attorneys to argue as *amici* in favor of positions neither of the parties had adopted.[11]

On June 28, 2012, the Court issued its decision, consisting of four opinions consisting of almost 200 pages.[12] The popular press described the decision as being 5 to 4 and as (1) upholding the ACA generally and the individual mandate specifically; but (2) rejecting the Medicaid expansion. But that is somewhat inaccurate. First, the opinions were so splintered that I think it is more accurate to describe it as a 1-2-2-3-1 vote.[13] Second, technically, the decision actually rejected the individual mandate, although it upheld the tax on individuals (and presumably businesses) that do not comply with the mandate.[14] Third, it held that Congress could not penalize states that refused to expand their Medicaid expansion by reducing the federal funding of the existing Medicaid program.[15] In this sense, it made the Medicaid expansion optional.

The Challenged Provisions

In these cases, two ACA provisions were in question: the "individual mandate" and the "Medicaid expansion." The "individual mandate" requires that, effective January 1, 2014, most Americans have "minimal essential [health] coverage."[16] Individuals who fail to meet this requirement are subject to what the statute calls either a "shared responsibility payment" or a "penalty."[17] Note that the "mandate" and the "penalty" are two different provisions, although they are intertwined and both included in the same IRC section.

Since its enactment in 1964, Medicaid has been a joint state-federal program. States are not required to participate in Medicaid, and in fact, Arizona did not have a Medicaid program until 1982! However, if a state elects to participate in Medicaid, it must meet the extensive federal requirements; in exchange, it receives extensive federal funding – which may be as high as 83% of the costs of the program. The ACA expands Medicaid to require inclusion of all individuals under age 65 with an income of less than 133% of the poverty level. At least currently, most of the costs of this expansion would be federally-funded.[18] But a state's failure to comply with this expansion would jeopardize not only the additional federal funds for the expansion but also the existing federal funds for its current program.

The Supreme Court's Decision, In Brief

The Court's majority[19] held that the individual mandate was unconstitutional because it was not authorized by the Commerce Clause.[20] While the prior cases had certainly expanded its scope, the majority said that the clause does not authorize federal regulation of *inactivity*; that is, all of the previous cases involved regulation of some degree of *activity*.[21] The Commerce Clause authorizes regulation of existing *activity*; it does not authorize Congress to require or to create activity.[22]

Chief Justice Roberts then turned to an alternate justification for the provision: although the mandate *per se* was unconstitutional, the "penalty" provision might not be. And the Court's majority[23] concluded that the penalty provision was in fact a tax and thus authorized under the Tax and Spending Clause.[24] Unlike the Commerce clause, this clause authorizes Congress to enact taxes to provide for the general welfare – a much broader concept than interstate commerce.[25]

As a result, it appears that we are left with a situation where there is no *requirement* for individuals to have health insurance, but they are subject to a tax if they fail to do so.

The Court next turned to the Medicaid expansion. States are separate sovereigns, and principles of federalism and the 10th Amendment generally prevent Congress from explicitly commandeering state instrumentalities. Nonetheless, Congress can use its spending power to "induce" states into certain actions; and by accepting federal money, states can be required to comply with all of the strings that Congress has attached to the money. But there is a difference between "inducing" and "coercing": Congress may do the former, but not the latter – the "State [must have] a legitimate choice whether to accept the federal conditions in exchange for the federal funds."[26] The Court found the Medicaid expansion coercive because a state that failed to meet the additional requirements would lose not only the additional funding for the additional requirements, but also much of its existing federal funding for its existing Medicaid program. This amounted to imposing a "retroactive" condition on old Medicaid, and no state could have agreed to such a large, unknown condition at the time it agreed to participate in Medicaid. This was an impermissible coercion.[27] But the solution was not to strike the entire Medicaid expansion or the entire ACA, but to strike only the offending provision: the provision that said a state would lose its funding for the existing Medicaid if it failed to meet the requirements of expanded Medicaid.[28] The expansion goes into effect; if a State fails to comply with the expansion's requirements, it can lose funding for the expansion, but not its existing funding.

With this background, we turn to the Legal Reminders and Ironies.

LEGAL REIMINDER 1: The Federal Government is a Government of Limited Powers; It Can Only Do Those things that the Constitution Authorizes It to Do.

The federal government's powers are limited. This is in contrast to state governments, which have the organic authority (under the concept of "police powers") to do anything that is not prohibited. But Congress can only act in the areas in which the Constitution gives it authority.[29]

This distinction exposes the fallacy in the argument that, if government can require people to maintain automobile insurance, it can require people to maintain health insurance. The automobile insurance requirement is a state, not a federal, requirement. (Further, the state requirements only apply to people who have engaged in activity, i.e., owning a car or driving. People who have not engaged in any activity are not required to maintain insurance.)

LEGAL REMINDER 2: The Anti-Injunction Act.

IRONY 1: Sometimes a Tax is not a Tax.

LEGAL REMINDER 3: The Same Word in the Same Law Can Have Different Meanings in Different Situations.

Although not mentioned in the brief summary of the Court's decision above, there was a preliminary issue that the Court addressed before it reviewed the Constitutional Challenges.

The federal Anti-Injunction Act (AIA) generally prohibits pre-payment taxpayer challenges to any federal tax.[30] Thus, the first question before the Court was whether the challenge to the individual mandate and its accompanying "exaction" could even be challenged at this point.[31]

The Court held that *for purposes of the AIA,* the individual mandate was not a tax. Obviously, that seems inconsistent with the Court's ultimate decision upholding the individual mandate as a tax. But since both the AIA and the ACA were Congressional creations, Congress could determine whether the AIA would bar pre-payment challenges to the ACA. Since Congress repeatedly stated that this was not a tax, it was clear that Congress did not mean to prevent pre-payment challenges.

In contrast, what is a tax, *for Constitutional purposes,* is not a Congressional determination, since the Constitution is not a Congressional creation. Thus, it doesn't matter whether Congress thought it was enacting a tax. If it constitutes a tax under the Constitutional provision, it is valid. And thus, a provision can be a tax for Constitutional purposes but not for AIA purposes.

Although the Court's analytical framework is probably right, question: was there enough evidence of a Congressional intent that the law could be challenged notwithstanding the AIA? The legislative history cited by the Court only involved the claims that this was not a "tax," but rather a "shared responsibility payment" or "penalty." In other words, the Court cited no legislative history addressing the impact of the AIA.

LEGAL REMINDER 4: The Constitution imposes Requirements Before Congress Can Enact a Tax.

Although Congress has the power to "lay and collect" taxes, the exercise of that power has limits and conditions.

First, Art. 1, Sec. 7 (the "Origination Clause,") requires that all bills imposing taxes originate in the House. Although the guts of the ACA certainly first appeared in the Senate, both public laws were originally House bills, which actually originated in the House. The Pacific Legal Foundation recently filed a challenge to the ACA on this ground, noting that the bill that eventually became PL 111-148 passed the House as the "Service Members Home Ownership Act of 2009"and that the Senate amended the amended the bill by striking the entire House language and inserted PPACA.[32] The Foundation argues that to say this was a House bill is an extreme case of putting form above substance – that the only thing in PL 111-148 that was in the bill that the House originally passed was the bill number.

Second, Art. 1, Sec. 9 provides, "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census . . . ." Of course, the 16th Amendment altered this provision when it authorized the income tax,[33] but it otherwise still applies. Chief Justice Roberts addressed this by simply noting that the Court's prior cases have limited this clause to per capita and real estate taxes. The Joint Dissent, while rejecting the characterization of the individual Mandate as a tax, also objected to the "lick-and-a-promise" consideration given to what it considered a "question of first impression."

LEGAL REMINDER 5: Severability.

At least since *Marbury v Madison,*[34] the Courts have had the authority to rule laws to be unconstitutional. But what is the result of exercising that power? Does one unconstitutional provision in a law make the other 300 constitutional provisions invalid?

The black-letter law seems to be, no. Judicial restraint and respect for the other branches of government suggest that a Court should only strike the unconstitutional provisions and let the remainder go into effect. (Admittedly, other provisions that are inextricably linked to the unconstitutional one may also have to be struck.) But the general rule is that the court's authority is limited to only the unconstitutional provisions; it is otherwise up to Congress to decide what laws should be adopted, whether wise or otherwise.[35]

The question was particularly difficult in this case: the ACA contained some 300 different provisions, many of which seemed unrelated to the two unconstitutional provisions. (It is, for example, hard to see the connection of the provision requiring employers to provide a private place for mothers to breastfeed to either the individual mandate or the Medicaid expansion.[36])

On the other hand, the ACA is a multi-faceted and intertwined bill designed to enact a comprehensive solution to the health care costs/access problem. Many have argued that the "consumer protections" adopted in Title I[37] could not be feasible economically unless all Americans were required to have health coverage. The Medicaid expansion was a way of covering an additional 16 million people, which again will add billions of dollars in payments to health care providers. Would the "grand bargain" embodied in the ACA have been adopted without the two unconstitutional provisions?[38]

Each of the Justices seemed to agree with the tests laid out at the beginning of this section. But they came to quite different conclusions as to how to apply the tests in this case. (That the four justices wanting to strike the entire law had previously found both the Medicaid expansion *and* the individual mandate unconstitutional – that is, two key provisions – may help explain the differing results.)

IRONY 2: Arguments that Help in Public and Getting a Law Passed may Hurt in Court.

It is no secret that many people dislike taxes. Therefore, in their attempt to get the individual mandate adopted, the proponents stressed that the failure to comply with the requirements individual mandate would not result in a tax, but rather in a "shared responsibility payment" or a "penalty."[39] Second, to further separate this "shared responsibility payment" from a tax, Congress limited the usual tools that the IRS has to collect taxes. Finally, to justify the individual mandate, the ACA included a long series of detailed "Congressional findings" seeking to justify the mandate as coming within Congress' commerce clause authority and stressing its importance to health care reform.[40]

But in order to get 5 votes in the Supreme Court, it was necessary to reverse course: the mandate was really a tax and the ACA's provisions were not so intertwined as to prevent severability.[41] (Again, question whether the Court would have found the ACA severable had the majority ruled the mandate and the Medicaid expansion both unconstitutional.) While this shift in position may have been embarrassing, it does not appear that the Court's majority was concerned, and one wonders if the Joint Dissent's commentary on it was more of a "gotcha" than a serious concern.

IRONY 3: By Opposing Individual ACA Provisions, Opponents of Federal Involvement in Health Care are Actually Hastening It.

There is a final irony which deserves mention. It is certainly fair to debate whether there is a health care problem worthy of federal action and whether ACA is the right way for Congress to act. It may also be admirable to stand on principle, regardless of the immediate outcome. But successful opposition to several specific ACA provisions will result in *increased* federal involvement, contrary to the presumed wishes of the opponents.

Two examples stand out:

1. ***The Effect of Making Medicaid Expansion Voluntary.*** As the result of this decision, states no longer are required to expand Medicaid. But Medicaid counted as coverage that would meet the requirement of the individual mandate. Therefore, if a state decides not to expand its Medicaid program, those individuals who would have been covered by expanded Medicaid will either have to pay the tax or obtain other health care coverage, presumably through the health insurance exchanges that will be set up in each state.

2. ***The Effect of Opposing a State Health Insurance Exchange in Michigan.*** The ACA requires that every state establish a private-sector exchange where individuals and businesses can go to obtain health insurance meeting the ACA's requirements. While subject to some federal requirements, states have broad authority in how to establish their individual exchange. Although technically government-run, the exchanges are comprised solely of private-sector insurers offering their policies to the public. In essence, the exchanges are a government-provided mechanism where the private sector can sell its goods and services. A number of state legislators in Michigan and in other states have opposed their state establishing its own exchange, presumably as part of their philosophical opposition to federal involvement in health care generally and to the ACA, in particular. But successfully blocking a Michigan exchange does not eliminate anything in the ACA; rather it simply means that the federal government will establish the Michigan exchange. So everything in the ACA will go into effect, it will just be done by the federal government, which is exactly the opposite of what the legislators profess to want.[42]

To add to these ironies, are the federal finance implications. The ACA provides for billions of dollars for funding both the Medicaid expansion and for helping the states establish the exchanges. So, if a state decides not to participate in these programs, some of its residents or businesses may be paying additional taxes to the federal government, the state will receive less federal aid, and its residents will be paying their normal federal taxes for the benefit of the residents of *other* states.

So, non-participation results in *increased* federal involvement and, if the opponents' fears are true, could lead to more federal involvement and control in the future.

About the Author

Mike Shpiece *focuses his practice on the areas of employee benefits, health care, insurance, and regulatory matters. He is an Adjunct Professor of Law at the Wayne State University Law School, teaching employee benefits. He is past chair of the Employee Benefits Committee of the Tort, Trial and Insurance Practice Section of the American Bar Association, and has been a member of the ABA's Joint Committee on Employee Benefits. He has been a frequent speaker and author on employee benefit and health care issues throughout the country. A graduate of the University of Michigan Law School, Mr. Shpiece is a former Deputy Director of the Michigan Department of Licensing and Regulation, and has served as President of the Farmington Board of Education. He is also a member of the American Statistical Association, the Economic Club of Detroit, the Healthcare Financial Management Association, and the Executive Committee of the Michigan Institution of Continuing Legal Education (ICLE).*

Endnotes

1 For an excellent discussion of the case and the underlying legal principles, *see* Howell and Clark, "'If it Quacks Like a Duck…' An Analysis of the United States Supreme Court Decision in *National Federation of Independent Business v. Sebelius,*" 24 The Health Lawyer 18 (No. 6, August 2012)(published by the ABA Health Law Section).

2 Technically, the ACA is the result of two laws: PL 111-148, the Patient Protection and Accountability Care Act, and PL 111-152, the Health Care and Education Reconciliation Act of 2010. As noted in the text, these laws adopted hundreds of provisions and amendments to several existing laws, including ERISA, the IRC, Public Health Services Act, the Fair Labor Standards Act, etc. (I describe – in very general terms – *some* of these provisions in notes 2 - 7. But these are general descriptions, most of which are subject to conditions, limitations, etc. And the categories I placed some of the provisions may be arbitrary: some would argue, for example, that encouraging breast feeding improves the child's health and is not just another provision "slipped" into an incredibly long bill.

The laws are also structured somewhat unusually. PL 111-148, the main law, contains 10 Titles. Titles I – IX adopt various substantive laws; then Title X amends various provisions of Titles I – IX. And then PL 14 -152 amends various provisions of PL 111-148 – including those previously amended by Title X.

3 Examples: the "individual mandate" and a comparable provision requiring employers to provide their employees with a minimum level of coverage or pay a penalty/tax; expanding the number of people eligible under state Medicaid programs; allowing adult children to remain on their parents' health insurance until age 27; limiting the ability of insurers to retroactively rescind health coverage; providing tax subsidies to encourage employers to provide and individuals to obtain health coverage; setting up high-risk and catastrophic care re-insurance pools; establishing the health insurance exchanges and make other improvement to improve accessibility to health insurance.

4 Examples: requiring health insurance to provide preventive care coverage at no cost to the patient reduce the "donut hole" in Medicare Part D Prescription Drug program, eliminating annual and lifetime maximums.

5 Examples: improve the availability of drugs and innovative therapies and make government approvals easier and quicker; increase student loans for people seeking to enter health care professions; funding training in family medicine, dentistry, mental health.

6 Examples: encourage Accountable Care Organizations ("ACOs"); add "program integrity

7 Examples: Centers of excellence; establishing best practices.

8 Examples: excise tax on high-cost benefit plans; 10% excise tax on indoor tanning services; 3.8% surcharge on investment income received by taxpayers with AGI's of more than $250,000 (married filing jointly, indexed). There are other provisions in other Titles that also may be considered taxes. For example, an individual who does not meet the "individual mandate" requirements is subject to an exaction, which has been variously called either a tax or a penalty.

9 Examples: require employers to provide nursing mothers with a private room in which they can nurse their children or express milk; establish "simple" cafeteria plans; limit the ability of "wellness plans" to threatened Second Amendment gun ownership rights.

10 Other constitutional challenges are either possible or ongoing. For example, several courts have addressed whether the requirement that plans cover preventative services and thus contraception violates the First Amendment at least in some cases. Virginia and some other states have also adopted state laws purporting to hold that the ACA and other federal health reform laws do not apply to Citizens of their state – an issue that I thought had been decided in 1865. *See, also,* US Constitution, Art.VI ("Supremacy clause"). And the Pacific Legal Foundation filed recently filed a lawsuit seeking a declaration that the Act violates the "Origination Clause," Art. I, Sec. 7 ("All bills for raising Revenue shall originate in the House of Representatives. . . .").

11 One amici argued that the tax anti-injunction act prevented the Court's consideration of the lawsuit. A second argued that the individual mandate is severable from the rest of the act.

12 *Nat. Fed. Of Ind. Business v. Sebelius*, ___ U.S. ___, 132 S.Ct. 2566 (June 28, 2012).

13 Chief Justice Roberts wrote the lead opinion. Justices Breyer, Ginsburg, Sotomayor, and Kagan joined parts of the opinion; Justices Breyer and Kagan joined other parts of the opinion; and Justices Scalia, Kennedy, Thomas, and Alito joined still other parts of the opinion. Justice Ginsburg wrote an opinion, in which Justice Sotomayor concurred; Justices Breyer and Kagen joined in part. Justices Scalia, Kennedy, Thomas, and Alito wrote a dissenting opinion. (Interestingly, this appears to be a jointly authored opinion, rather than a Scalia opinion in which the others joined.) And Justice Thomas also filed a short dissenting opinion, which essentially sought to overrule the last 2/3 century of the Court's commerce clause jurisprudence.

If this is Chief Justice Roberts first key constitutional opinion, it is interesting to compare this splintering with the unanimous opinion Chief Justice Warren was able to achieve in his first key constitutional opinion, *Brown v. Board of Education*, 347 US 483 (1954).

14 The Court held that Congress did not have the power under the Commerce Clause to require individuals to buy insurance, but it did have the power under the Taxing Clause to tax uninsured individuals, and thus "encourage" individuals to buy insurance.

15 Medicaid has always been voluntary on the part of the states. But if a state adopts a Medicaid program that meets federal requirements, the federal government pays 50-80% or more of the costs. As a result, every state currently has a Medicaid program. But each state is technically free to drop its program, although it would result in a loss of significant federal funds.

16 Codified in the Internal Revenue Code, at 26 USC 5000A(a). The requirement does not apply to an individual who has a religious objection, who is a member of a "health care sharing ministry," who is an illegal alien, or who is in jail. 26 USC 5000A(d). Effectively also exempt are certain low-income individuals, members of Indian tribes, and certain other individuals. 26 USC 5000A(e). Included as "minimum essential coverage" are a whole range of health coverage, including Medicare, Medicaid, CHIP, individual health coverage, and qualifying employer-provided coverage. 26 USC 5000A(f).

17 26 USC 5000A(b).

18 42 USC 1396d(y)(1) provides 100% of the additional costs will be federally funded in 2014-2016; that percentage would be gradually reduced to 90% in 2020 and all following years.

19 By 5 (Roberts, Scalia, Kennedy, Thomas, and Alito) to 4 (Breyer, Ginsburg, Sotomayor, and Kagan).

20 The Commerce Clause authorizes Congress "To regulate Commerce . . . among the several States." Art. I, Sec. 8, Clause 3. Over the years, the Court has interpreted this to allow regulation of the channels of interstate commerce, persons or things in interstate commerce, and purely intrastate activities which have a substantial effect on interstate commerce. [NOTE: the Constitution includes some unusual spelling and capitalization practices, which are reflected in this article.]

21 In the past, the Court had upheld federal regulation of solely intra-state that had an impact on interstate commerce, but those cases still involved activity rather than inactivity. *See, Wickard v. Fillburn*, 317 US 111 (1942)(upholding application of a federal law limiting wheat production to a farmer growing wheat for his personal use only; although the farmer himself was growing only for *intra*-state commerce, his and others' activity could in the aggregate have a substantial effect on *intra*-state commerce).

22 The Court also rejected the argument that the Necessary and Proper Clause authorized the law, stating that although the Necessary & Proper clause might authorize the implementation of a law, the underlying law must still be authorized under some other provision of the Constitution. (The Necessary & Proper Clause authorizes Congress "To make all Laws which shall be necessary and proper for carrying into Execution" its authority and that of the US Government. Art. I, Sec. 8, clause 18.)

23 Again, 5 to 4, but with a complete switch of the 4.

24 The Tax and Spending Clause authorizes Congress to "lay and collect Taxes. . . to pay the Debts and provide for the common Defence and general Welfare of the United States." Art. I, Sec. 8, Clause 1. Although it is not clear from its text, this clause has been interpreted as authorizing any spending designed to provide for defense or the general welfare.

25 This is not a trivial distinction, because the range of authorized Congressional actions varies greatly depending on whether it is regulating commerce or simply imposing a tax. As Chief Justice Roberts observed, "Once we recognize that Congress may regulate a particular decision under the Commerce Clause, the Federal Government can bring its full weight to bear. . . . By contrast, Congress's authority under the taxing power is limited to requiring an individual to pay money into the Federal Treasury, no more." 132 S.Ct. at 2600.

26 *NFIB,* at 2602-3. (Roberts, CJ.)

27 The vote on this was 7 to 2, with only Ginsburg and Sotomayor in the minority.

28 The vote on this was the usual 5 to 4.

29 Most grants of Congressional authority are found in Article I, Section 8, which has 18 clauses granting various powers to Congress. But other provisions and some of the Constitutional Amendments also grant authority to Congress, *see, e.g.,* Amendment XVI, authorizing Congress to levy an income tax. It is debatable how strictly those clauses should be read. For example, although Congress is explicitly authorized "To raise and support Armies" and "To provide and maintain a Navy," *Clauses 12* and 13, there is no named authorization for an air force.

30 26 USC 7421(a). Generally, a taxpayer must pay the disputed tax, file a refund claim, and then sue for a refund. Alternatively, if the tax is assessed as the result of an IRS audit, a taxpayer can sue after it has fought against an asserted tax deficiency in the US Tax Court. 26 USC 7428 also provides a limited exception to this rule for disputes over the tax exempt status of certain organizations.

31 Interestingly, although this issue had been argued in the lower courts, when the case got before the Supreme Court, the parties decided that they wanted a decision on the merits and thus both sides took the position that the AIA did not bar the suit. The Court, however, determined that this was a serious jurisdictional question and appointed an amici to argue that the AIA applied.

32 The case is *Sissel v. US Dep't of HHS*, No. 1:10-cv-01263.

33 The 16th Amendment provides: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States and without regard to any census or enumeration."

34 1 Cranch 137 (1803)(holding part of a statute unconstitutional but allowing the rest to go into effect).

35 This test has also been phrased as which provisions of the law would Congress have enacted had it not enacted the unconstitutional provision? Of course, this is a lot like one wag's cynical phrasing that the goal of statutory construction is to determine what Congress intended about an issue it never explicitly decided.

36 The breastfeeding provision only applies to employers engaged in interstate commerce and thus there was no constitutional challenge.

37 See footnote 3, above.

38 The Joint Dissent argued to strike even the "minor," non-challenged provisions:

> Some provisions, such as requiring chain restaurants to display nutritional content, appear likely to operate as Congress intended, but they fail [because there] is no reason to believe that Congress would have enacted them independently. . . . When we are confronted with such a so-called "Christmas tree," a law to which many nongermane [sic] ornaments have been attached, we thing the proper rule must be that when the tree no longer exists the ornaments are superfluous.

39 The ACA also requires many employers to provide health coverage to their employees or to pay an "assessable penalty." 26 USC 4980H. This section is entitled "Shared Responsibility for Employers Regarding Health Coverage." In other words, the ACA avoids enforcing the mandates of coverage with a tax; it simply imposes costs on those who fail to meet their "shared responsibility," whether they are employers or individuals.

40 PPACA, Sec. 1501(a) and (b), as amended by Sec. 10106(a).

41 An earlier version of PPACA actually had an explicit severability provision, stating that if any provision was unconstitutional, it would not impact the effectiveness of the other provisions. This severability provision was deleted by the proponents, presumably because they wanted to eliminate an incentive to rule some provision unconstitutional. In another irony, the Chief Justice's opinion seemed to rely on the pre-existing severability provision in the Medicaid act. 132 S.Ct. at 2607 (Roberts, CJ). The severability clause the Chief Justice relied on is 42 USC 1303, which part of the original Social Security Act, adopted in 1935. (Medicaid is actually Title XIX of the Social Security Act, which is why this provision was relevant.).

42 Gov. Snyder has announced that the federal government as agreed to allow a joint Michigan-federal partnership establish the Michigan exchange. Even so, it is likely to have more federal involvement and control than a solely Michigan-established exchange.

BEWARE OF BEING A PREPARER

By Neal Nusholtz

The Internal Revenue Service estimates that between $11 billion and almost $14 billion in erroneous Earned Income Tax Credit (EITC – a refundable credit for low income taxpayers) clams are paid annually.[1] Two-thirds of all EITC claims are prepared by paid tax return preparers. For 2011, the government decided to increase the penalty from $100 to $500 for each preparer's failure to comply with due diligence requirements in preparing a tax return.[2]

Taxpayers cannot possibly cope with the complexity of our tax system. The solution under the EITC is to shift the burden to professionals to implement the rules and police taxpayers who might try to get around the rules, or a professional will face penalties. There are many different examples of this type of burden being placed on tax return preparers. But while the government has made it harder to be a tax return preparer, they have also made it easier to be tax preparer, by accident, as in the following example:

> Prior to the sale of a $5 million business, an attorney writes an opinion where the tax savings could be $1 million. The attorney charges for 3 hours of work. The following tax season, the client returns to the attorney's office with a draft of his tax return. It shows the sale and the client wants review and final approval. The attorney looks at it for 10 minutes, sees the sale property reported, and gives the draft his approval.

Question: Is the attorney required to sign the tax return?

Answer: The attorney may be a signing tax return preparer of a tax return if he or she is primarily responsible "for the overall substantive accuracy of the preparation of such return"[3]. The attorney will be a non-signing tax return preparer if: (1) someone else has final say on the return;[4] (2) the advice given[5] relates to items on the return that are "substantial;"[6] and (3) at least 5% of the advice occurs after the pertinent facts have occurred.[7] A substantial portion of the return is an item which is: (1) a "substantial portion of the tax" and (2) an item of gross income or a deduction of at least: (1) $10,000.00 or (2) $400,000 and at least 20% of the gross income on the return[8].

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Professionals could inadvertently run afoul of the preparer rules and the rules are numerous (they are listed at length below). A good place to start would be a discussion about the differences between a signing return preparer and a non signing return preparer.

Table of Differences Between *Signing and Non Signing Preparers*

Topic	Signing Preparer	Non Signing Preparer
Definition	"A signing tax return preparer is the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of such return or claim for refund."[9]	"A non signing tax return preparer is any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a return or claim for refund within the meaning of paragraph (b)(3) of this section with respect to events that have occurred at the time the advice is rendered. In determining whether an individual is a non signing tax return preparer, time spent on advice that is given after events have occurred that represents less than 5 percent of the aggregate time incurred by such individual with respect to the position(s) giving rise to the understatement shall not be taken into account. Notwithstanding the preceding sentence, time spent on advice before the events have occurred will be taken into account if all facts and circumstances show that the position(s) giving rise to the understatement is primarily attributable to the advice, the advice was substantially given before events occurred primarily to avoid treating the person giving the advice as a tax return preparer, and the advice given before events occurred was confirmed after events had occurred for purposes of preparing a tax return. Examples of non signing tax return preparers are tax return preparers who provide advice (written or oral) to a taxpayer (or to another tax return preparer) when that advice leads to a position or entry that constitutes a substantial portion of the return within the meaning of paragraph (b)(3) of this section. "[10]
Definition of "Substantial Portion"		"A person who renders tax advice on a position that is directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim for refund will be regarded as having prepared that entry. Whether a schedule, entry, or other portion of a return or claim for refund is a substantial portion is determined based upon whether the person knows or reasonably should know that the tax attributable to the schedule, entry, or other portion of a return or claim for refund is a substantial portion of the tax required to be shown on the return or claim for refund. A single tax entry may constitute a substantial portion of the tax required to be shown on a return."[1]1
Exceptions from Substantial Portion Rules		(1) Less than $10,000; or (2) Less than $400,000 and also less than 20 percent of the gross income as shown on the return or claim for refund (or, for an individual, the individual's adjusted gross income). [12]

Topic	Signing Preparer	Non Signing Preparer
Examples under Treas. Reg. §301.7701-15(b)(2) :		Example 2. Attorney B, an attorney in a law firm, provides legal advice to a large corporate taxpayer regarding the tax consequences of a proposed corporate transaction. Based upon this advice, the corporate taxpayer enters into the transaction. Once the transaction is completed, the corporate taxpayer does not receive any additional advice from B with respect to the transaction. B did not provide advice with respect to events that have occurred and is not considered a tax return preparer. Example 3. The facts are the same as Example 2, except that Attorney B provides supplemental advice to the corporate taxpayer on a phone call after the transaction is completed. Attorney B did not provide advice before the corporate transaction occurred with the primary intent to avoid being treated as a tax return preparer. The time incurred on this supplemental advice by B represented less than 5 percent of the aggregate amount of time spent by B providing tax advice on the position. B is not considered a tax return preparer. [13]
Date Return is Deemed Prepared	Date signed, if unsigned, date filed.[1]4	Date non signing Preparer provides advice"[1]5
Obligation for Accuracy on the Return	"Primary Responsibility for the overall substantive Accuracy" [16]; unless it is determined that the signing preparer is not responsible for the position and there is a non signing tax preparer within the firm with overall supervisory responsibility for the position(s) giving rise to the understatement. [17] A penalty may be assessed against a signing or non signing preparer in the same firm but not both.[18] Note that this rule does not apply to people in different firms. [19]	If "based upon credible information from any source, it is concluded that the signing tax return preparer is not primarily responsible for the position(s) on the return "[20]A penalty may be assessed against a signing or non signing preparer in the same firm but not both. [21] Note that this rule does not apply to people in different firms.[22]
§6694 Penalty	the amount of penalties assessed against the individual and the firm shall not exceed 50 percent of the income derived (or to be derived) by the firm from the engagement of preparing the return or claim for refund or providing tax advice …The portion of the total amount of the penalty assessed against the individual tax return preparer shall not exceed 50 percent of the individual's compensation as determined under paragraphs (f)(1) and (2) of this section. [23]	
§6694 Adequate Disclosure	From 8275 or 8275-R, disclosure under 1.6662-4(f), or if other than accuracy related penalties, contemporaneously documented advice to the taxpayer [24]	Disclosure on the Tax return the same as for a signing tax preparer[25] or if the advice is provided to a taxpayer "if the tax return preparer advises the taxpayer of any opportunity to avoid penalties under section 6662 that could apply to the position, if relevant, and of the standards for disclosure to the extent applicable. The tax return preparer must also contemporaneously document the advice in the tax return preparer's files."[26] If advice is provided to another tax preparer disclosure is adequate if the other tax return preparer [is advised] that disclosure under section 6694(a) may be required. The tax return preparer must also contemporaneously document the advice in the tax return preparer's files.[27]

Topic	Signing Preparer	Non Signing Preparer
Duties under 1.6695-1	• Furnish copy • Sign Return • Furnish identifying number on return • Retain Copy • Cannot Negotiate Client's Refund Checks	
§6695 Earned income Tax Credit	Prepare 8867.[28] Retain Form 8867, a completed Earned Income Credit Worksheet, a record how and when the information used to prepared the 8867 was obtained[29] for 3 years from the latest of: (1) due date of the return; (2)date of filing; (3)if not filed, date presented.[30]	Provide Signing Return Preparer with a Completed form 8867. Records are retained three years from the date "the date the nonsigning tax return preparer submitted to the signing tax return preparer that portion of the tax return or claim for refund for which the nonsigning tax return preparer was responsible."[31]

Table of Illustrative *Preparer Issues*[32]

Question	Holding	Cite
Can a general partner who prepares the partnership return be considered a preparer of the Limited Partners tax return subject to penalties for negligent or intentional disregard of rules and regulations from the understatement of tax on a limited partner's return?	Yes, if the General Partners has been compensated and the K-1 entries are a substantial Portion of the Limited Partner's tax return. Preparation "of a Schedule K-1, which provides information relating to specific amounts of income, deductions, and credits for each partner [is] advice [that] is directly relevant to the existence, characterization, and amount of entries on each partner's return." (GCM 38747)	Rev. rul. 81-2701981-2 CB 250; GCM 38746 (6/5/81)
An attorney receives a signed return prepared by his client for review with instructions to send it in if no changes are needed. The attorney reviews the return for correctness, asks a few questions and sends the return in for filing. Is the attorney required to sign the tax return or, if not, be subject to a penalty under §6695?	Yes.	Situation 4 Rev. Rul. 84-3 1984-1 C.B. 264
An attorney receives a draft of a tax return, and advises the client to make substantial changes, which the client does before mailing it in. Is the attorney subject to a §6695 penalty for not signing the return.	Yes, unless the attorney can prove he made a request to receive the revised return for signature and the request was not honored. In the alternative, a preparer may draft a return based on available information and sign and send it to the taxpayer. (GCM 29322 (1/10/85))	Situation 3 Rev. Rul. 84-3 1984-1 C.B. 264

Question	Holding	Cite
An attorney writes a tax opinion for a substantial item on a tax return for a company that has its own tax department and the tax department makes final decisions on tax matters. Is the attorney required to sign the tax return?	No. A person who is a preparer solely because they have given advice on a specific issue of law under §301.7701-15(a)(2) and (b) is not required to sign the return where "the extent of review" does not include the final decision as to an item on the Return.	1.6695(b)(95). PLR 792033

Summary of Applicable Code Sections and *Other Provisions That Apply to Preparers*:

IRC § 6694 – Understatement of taxpayer's liability by tax return preparer.

IRC § 6694(a) – Understatement due to unreasonable positions. The penalty is the greater of $1,000 or 50% of the income derived by the tax return preparer with respect to the return or claim for refund.

IRC § 6694(b) – Understatement due to willful or reckless conduct. The penalty is the greater of $5,000 or 50% of the income derived by the tax return preparer with respect to the return or claim for refund.

IRC § 6695 – Other assessable penalties with respect to the preparation of tax returns for other persons.

IRC § 6695(a) – Failure to furnish copy to taxpayer. The penalty is $50 for each failure to comply with IRC § 6107 regarding furnishing a copy of a return or claim to a taxpayer. The maximum penalty imposed on any tax return preparer shall not exceed $25,000 in a calendar year. And ERO (Electronic Return Originator) must provide a form 8453 an a printout of the electronic portion of the return.

IRC § 6695(b) – Failure to sign return. The penalty is $50 for each failure to sign a return or claim for refund as required by regulations. The maximum penalty imposed on any tax return preparer shall not exceed $25,000 in a calendar year. See Notice 2004-54 (Alternative methods of signing include signature from computer software program.

IRC § 6695(c) – Failure to furnish identifying number. The penalty is $50 for each failure to comply with IRC § 6109(a)(4) regarding furnishing an identifying number on a return or claim. The maximum penalty imposed on any tax return preparer shall not exceed $25,000 in a calendar year.

IRC § 6695(d) – Failure to retain copy or list. The penalty is $50 for each failure to comply with IRC § 6107(b) regarding retaining a copy or list of a return or claim. The maximum penalty imposed on any tax return preparer shall not exceed $25,000 in a return period.

IRC § 6695(e) – Failure to file correct information returns and keep employee records. The penalty is $50 for each failure to comply with IRC § 6060. The maximum penalty imposed on any tax return preparer shall not exceed $25,000 in a return period. A person who employs someone to prepare tax returns other than their own is require to keep a record of the name,s taxpayer identification numbers, and places of work of each employee for a 12 month period starting on July 1 of each year ("the return period") and make that record available to the Internal Revenue Service upon request or the 3-year period following the close of the return period to which that record relates.

IRC § 6695(f) – Negotiation of check. The penalty is $500 for a tax return preparer who endorses or negotiates any check made in respect of taxes imposed by Title 26 which is issued to a taxpayer.

IRC § 6695(g) – Failure to be diligent in determining eligibility for earned income credit. The penalty is $500 for each failure to comply with the EIC due diligence requirements imposed in regulations.

IRC § 6700 – Promoting abusive tax shelters

The penalty is for a promoter of an abusive tax shelter and is generally equal to $1,000 for each organization or sale of an abusive plan or arrangement (or, if lesser, 100 percent of the income derived from the activity).

IRC § 6701 – Penalties for aiding and abetting understatement of tax liability.

The penalty is $1000 ($10,000 if the conduct relates to a corporation's tax return) for aiding and abetting in an understatement of a tax liability. Any person subject to the penalty shall be penalized only once for documents relating to the same taxpayer for a single tax period or event.

IRC § 6713 – Disclosure or use of information by preparers of returns.

The penalty is $250 for each unauthorized disclosure or use of information furnished for, or in connection with, the preparation of a return. The maximum penalty on any person shall not exceed $10,000 in a calendar year. Under Treas. Reg. 301.7216-2(h) tax return information amon authorized IRS e-file providers is permitted. Treas. Reg. 301.7216 requires consents from a taxpayer in order to use taxpayer information for any purpose other than the preparation of a tax return.

IRC § 7206 – Fraud and false statements.

Guilty of a felony and, upon conviction, a fine of not more than $100,000 ($500,000 in the case of a corporation), imprisonment of not more than three years, or both (together with the costs of prosecution).

IRC § 7207 – Fraudulent returns, statements, or other documents.

Guilty of a misdemeanor and, upon conviction, a fine of not more than $10,000 ($50,000 in the case of a corporation), imprisonment of not more than one year, or both.

IRC § 7216 – Disclosure or use of information by preparers of returns.

Guilty of a misdemeanor for knowingly or recklessly disclosing information furnished in connection with a tax return or using such information for any purpose other than preparing or assisting in the preparation of such return. Upon conviction, a fine of not more than $1,000, imprisonment for not more than 1 year, or both (together with the costs of prosecution).

IRC § 7407 – Action to enjoin tax return preparers.

A federal district court may enjoin a tax return preparer from engaging in certain proscribed conduct, or in extreme cases, from continuing to act as a tax return preparer altogether.

IRC § 7408 – Action to enjoin specified conduct related to tax shelters and reportable transactions

A federal district court may enjoin a person from engaging in certain proscribed conduct (including any action, or failure to take action, which is in violation of Circular 230).

Note: Please see the Internal Revenue Code, corresponding Treasury Regulations, and other related published guidance for additional information on each penalty section.

Circular 230 Section 10.21 Obligation to Advise of Consequences of Noncompliance, Error or Omission

§ 10.21 Knowledge of client's omission A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.

Circular 230 Section 10.21 Dilgence as to Accuracy

§ 10.22 Diligence as to accuracy. (a) *In general.* A practitioner must exercise due diligence — (1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

Specific Rules Applying to *Earned Income Tax Credit*

Generally, four requirements must be met by Return Preparers to avoid a penalty under §IRC 6695(g), which requires due diligence in the course of preparing tax returns with an earned income tax credit.

First, the tax preparer must complete either Form 8867 or its equivalent, and complete an eligibility checklist based on information provided by the taxpayer for the tax preparer.

Second, the preparer must keep the EIC worksheet or equivalent that demonstrates how the EITC was computed. The preparer must keep either: (1) the Earned Income Credit Worksheet in the Form 1040 Instructions or (2) a record in the electronic files of the calculation, including the method and information used. The worksheet may be prepared based on information provided by the taxpayer, or otherwise reasonably obtained by the preparer.

Third, the preparer must not know or have reason to know, at the time of the preparation of the return, that any information used in determining the taxpayer's eligibility for, or the amount of, the EITC is incorrect, incomplete or inconsistent. In satisfying this knowledge requirement, the taxpayer must also (1) not ignore the implications of information furnished or known, (2) make reasonable inquiries if a reasonable and well-informed tax return preparer, knowledgeable in the law, would conclude the information furnished appears to be incorrect, inconsistent or incomplete, and (3) document in his/her records any additional inquiries and responses made. Whenever a preparer knows or has reason to know that more than one taxpayer is seeking to claim the EIC for the same child, a penalty will be asserted if the preparer does not apply the tie breaker rules, which are: (1) between a parent and a non parent, the parent; (2) if neither claimants are parents, the one with the higher Adjusted Gross Income; (3) if both claimants are parents who do not file jointly, the parent with whom the child lived longest during the year; and (4) if both parents are claimants and their time with the child is equal, the one with the higher adjusted gross income.

> **IRS Publication 4687** defines Due Diligence:
>
> IRS assesses most due diligence penalties for failure to comply with the knowledge requirement. To meet the knowledge requirement, you should:
>
> - Apply a common sense standard to the information provided by your client
> - Evaluate whether the information is complete and gather any missing facts
> - Determine if the information is consistent; recognize contradictory statements and statements you know not to be true
> - Conduct a thorough, in-depth interview with every client, every year
> - Ask enough questions to reasonably know the return is correct and complete
> - Document in the file any questions you asked and your client's responses, as it happens.
>
> If a Return Preparer receives conflicting information from two different taxpayers, the return preparer has an affirmative duty to request verification from both taxpayers to determine which information is correct and to only file a return with information the preparer does not know or have reason to know is incorrect (CCA 200029008)

Lastly, the due diligence requirements relating to record retention require that the preparer retain the Form 8867 (or its equivalent) and the EITC worksheet, maintain a record of how and when the information used to complete these forms was obtained, verify the identity of the person furnishing the information, and retain the records on paper or electronically for three years after the latest of:
(A) The due date of the tax return (determined without regard to any extension of time for filing);

(B) In the case of a signing tax return preparer electronically filing the tax return or claim for refund, the date the tax return or claim for refund was filed;

(C) In the case of a signing tax return preparer not electronically filing the tax return or claim for refund, the date the tax return or claim for refund was presented to the taxpayer for signature; or

(D) In the case of a nonsigning tax return preparer, the date the nonsigning tax return preparer submitted to the signing tax return preparer that portion of the tax return or claim for refund for which the nonsigning tax return preparer was responsible.

Exception to penalty. The section 6695(g) penalty will not be applied with respect to a particular tax return or claim for refund if the tax return preparer can demonstrate to the satisfaction of the IRS that, considering all the facts and circumstances, the tax return preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements of paragraph (b) of this section, and the failure to meet the due diligence requirements of paragraph (b) of this section with respect to the particular tax return or claim for refund was isolated and inadvertent. The preceding sentence does not apply to a firm that is subject to the penalty as a result of paragraph (c) of this section.[33]

Manner of Assessment

Preparer penalties will be assessed in the same manner as taxes. Preparers subject to proposed penalties will be sent a 30 day Letter 1125 (Transmittal of Examination Report) and if a response to the 30 day letter is not made, the penalty will be assessed.[34] Preparer penalties will not be submitted to Appeals if less than 180 days remain on the statute of limitation. A request for extension of the statute will be made and if not granted, the penalty will be assessed.[35] Once assessed, the penalty must be paid and a claim for refund filed to obtain a hearing. Except in §6694, §6695 and §6713 cases, if a hearing in appeals has not been previously granted, one will be granted on filing a claim for refund.[36] In §6694, §6695 and §6713 cases, an appeals hearing will be granted even if the preparer was previously granted an appeals hearing pre-assessment.[37]

Conclusion

Well, that covers the complete landscape of rules that apply to preparers, including people who might not think they are preparers. Once facts have occurred upon which tax advice is given, no simple rule of thumb exists which, if followed, will exempt anyone from the application of all of these rules. So, be prepared to be a preparer and keep the following in mind. In a parting statement before he left IRS, David Williams, the former director of the IRS Return Preparer Office (RPO), acknowledged there were doubts among the tax professional community about the agency's ability "to halt preparer fraud and root out non-signing preparers." IRS considers this a high priority, Williams said in a statement posted on Facebook on Sept. 4.

About the Author

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Endnotes

1 IRS EITC Fact Sheet. Data for TY 2008 through June 30, 2009. Available at: http://www.eitc.irs.gov/rptoolkit/compliance.

2 112th Congress, Committee Report for JCS-3-11: "Increase penalty imposed on paid preparers who fail to comply with Earned Income Tax Credit ("EITC") due diligence requirements "

3 Treas. Reg. 301.7701-15 (a)

4 PLR 7902033

5 §301.7701-15(b)(3)

6 Treas. Reg. 301.7701-15(b)(2)

7 Treas. Reg. 301.7701-15(b)(2)

8 §301.7701-15(b)(3)(ii)

9 §301.7701-15(b)(1)

10 §301.7701-15(b)(2)

11 301.7701-15(b)(3)

12 §301.7701-15((b)(3)(ii)

13 301.7701-15(b)(2) Examples 2 and 3:

14 1.6694-1(a)(2)

15 1.6694-1(a)(2)

16 §301.7701-15(b)(1)

17 §1.6694-1(b)(3) and 1.6694-1(b)(6) Example 1.

18 §1.6694-1(b)(4)

19 (See §1.6694-1(b)(6) Example 4.)

20 §1.6694-1(b)(2)

21 §1.6694-1(b)(4)

22 (See example 4 §1.6694-1(b)(6) Example 4."Same as Example 1, except Attorney D, who works for a different firm than A [signing preparer], also provides advice on the same position upon which A relies. It may be concluded that D is [in addition to B] also primarily responsible for the position on the return and may be subject to penalty under section 6694."

23 §1.6694-1(f)(3)

24 §1.6694-2(d)(3)i(A)-(C)

25 §1.6694-2(d)(3)(ii)

26 §1.6694-2(d)(3)(ii)(A)

27 §1.6694-2(d)(3)(ii)(B)

28 §1.6695-2(b)(1)(C)

29 §1.6695-2(b)(4)(i)

30 §1.6695-2(b)(4)(i)

31 §1.6695-2(b)(4)(ii)

32 This list can be found on the IRS website under Summary of Preparer Penalties under Title 26

33 1.6695-2(d)

34 Internal Revenue Manual 20.1.6.19.1(2)

35 Internal Revenue Manual 20.1.6.19.1(3)

36 Internal Revenue Manual 20.1.6.19.3

37 Internal Revenue Manual 20.1.6.19.4

Student Tax Notes

Chevron Deference in Tax Law Following the Supreme Court's Decision in *Mayo Foundation v. United States*

By Dmitry Zelik

Introduction

In light of the Supreme Court's recent decision in *Mayo Foundation v. United States*, (*Mayo),* trying to challenge Treasury Department regulations by using dictionary interpretations along with various conceptual arguments, might become a thing of the past.[1]

Most of the Treasury regulations are promulgated under the general authority to "prescribe all needful rules and regulations for the enforcement," also known as "general authority" regulations.[2] Lower courts have not been uniform in their decisions in regard to the extent of judicial deference applicable to general authority tax regulations. Some courts relied on factors detailed under the *Muffler* factors,[3] whereas other courts based their decision on the *Chevron* deference.[4] Applying different deference standards often determined the fate of the 'attacked' regulation, and consequently, the outcome of the case. A case that vividly highlights this problem was *Mayo.*

When *Mayo* eventually reached the Supreme Court, one question was clearly answered – courts must fully apply the *Chevron* deference formula in the tax context. This ruling provided the Treasury Department with a substantial legislative power which may be used not only to improve administrability but also to gain a litigation advantage. These and other possible implications of *Mayo* will be briefly discussed in this article.

An Overview and Outcome of *Mayo Foundation v. United States*

On January 11, 2011, the United States Supreme Court decided *Mayo Foundation v. United States,* upholding a Treasury Department regulation by applying the deferential standard of *Chevron*.

Mayo Foundation filed a suit to the district court of Minnesota asserting that its medical residents were exempt from the Federal Insurance Contributions Act (FICA) taxes under I.R.C. §3121(b)(10) and that the Service's amended regulation, interpreting students' exemption under FICA, was invalid.[5]

FICA requires employees and employers to pay tax on all wages, with the exceptions detailed in I.R.C. §3121(b), one of which exempts from tax any "service performed in the employ of … a school, college, or university … if such service is performed by a student who is enrolled and regularly attending classes at [the school]" §3121(b)(10). Because the term "student" was not defined in the Code, the Treasury Department issued regulations stating that any medical resident whose normal schedule requires him to perform services of 40 or more hours per week *is not a student*. The district court agreed with Mayo Foundation, and by applying *Muffler* factors,[6] as opposed to *Chevron*'s deference stated that the amended regulation was invalid, and inconsistent with the FICA provisions.

The United States Court of Appeals for the Eighth Circuit reversed the grant of summary judgment to the petitioner, stating that FICA is silent and ambiguous on the question of "whether a medical resident working for the school fulltime is a 'student'" for the purposes of I.R.C. §3121(b)(10) and that the amended regulation was a permissible interpretation of the statute.[7]

In a unanimous decision written by Chief Justice John G. Roberts Jr., the Supreme Court held that *Chevron* deference applies with full force in the tax context, meaning that the Treasury and the Service have the power of an administrative agency to formulate the policy and make the rules to fill any gaps left by the Congress.[8]

What is the Difference between *Chevron* Deference and *Muffler* Factors?

Chevron deference is one of the most important principals in the administrative law, and after *Mayo,* it has also become important in the Federal tax procedures. In *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.,* the Supreme Court set forth a famously deferential two-part analysis.[9] First, the court asks whether the Congress has "directly addressed the precise question at issue."[10] If the answer is negative, the court follows the second part of the analysis – whether the agency's rule is based on a permissible construction of the statute.[11]

Muffler factors,[12] on the other hand, call for a different analysis regarding ambiguous statutes. In *Muffler,* the Court required taking into account "whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose," consequently, a court might view an agency's inconsistent interpretation of a statute with heightened skepticism.[13]

Thus, under *Chevron* the courts' role is more limited due to a higher level of deference to the interpretive regulations, as long as the regulations are "permissible construction of the statute."[14] Under *Muffler*, however, courts were viewed as the primary interpreters of statutory text, and by relying upon various factors, could impose their own interpretation or position if the regulations were not consistent with the statute.[15]

Mayo's Impact on the Tax World

Treasury Regulation – Robust but not Immune

In *Mayo*, the Supreme Court finally resolved a long standing debate and gave both more clarity to the Federal tax procedures and more consistency with other areas of law, by adopting a uniform approach to a judicial review of administrative action in tax law, and shifting the focus from the courts to the agencies in interpreting statutory ambiguities.

Mayo symbolizes the departure from the previous practice where the Service's interpretation of tax statutes had less force of law. The ruling substantially reduced taxpayers' options for confronting regulations using a dictionary interpretation of the terms and expressions, and possibly, improved tax administrability.

It might still be possible to challenge a Treasury regulation using *Chevron*'s first part analysis, arguing that the statute has unambiguous language and therefore does not need an agency, i.e., the Treasury, to fill in the gaps with its own interpretation.[16] Practically, a given court's interpretation of the statute could make it "unambiguous," and therefore, an alternative interpretation by Treasury regulations might be invalid, according to *Chevron* deference.[17]

Temporary Regulations, Proposed Regulations, Revenue Rulings and Revenue Procedures

Following the Supreme Court's decision in *Mayo*, the Department of Justice stated that it will no longer argue for *Chevron* deference in revenue rulings and revenue procedures.[18]

Gilbert Rothenberg, appellate section chief in the Department of Justice's Tax Division, stated that only temporary regulations are entitled to *Chevron* deference and that the Department would not argue that the proposed regulations should also be accorded deference.[19]

> "proposed regulations are simply 'this is what the IRS thinks may be a good idea,' but it wants to hear from everybody else. . . . Temporary regulations are 'we've got to get something out right now and we want people to pay attention to it.'"[20]

However, it should be noted that *Mayo* dealt with a *final* regulation and did not address the level of deference of the *temporary* regulations, both of which are very similar, with the exception that the temporary regulations are issued very rarely, after notice and comment procedure according to the Administrative Procedure Act.[21] Therefore, it is still unclear whether temporary regulations are entitled to *Chevron* deference or, perhaps, a stricter judicial review is required in cases in which the regulations did not benefit from notice and comment or a similar process.[22] Some courts of appeals are deterred from a full application of *Mayo* and *Chevron* deference to temporary regulations.[23] However, other courts, such as the Court of Appeals for the Seventh Circuit, indicate an opposite tendency that is towards full implementation of the *Chevron* deference, in both temporary and final regulations.[24]

Conclusion

Some are concerned with the fact that *Mayo* has provided the Service with a substantial legislative authority with little judicial review.[25]That power might be used, for example, to overturn court results and gain an unfair litigation advantage, simply by promulgating proper regulations.[26] Leandra Lederman addressed this issue in detail pointing out the courts' attitude towards "fighting regs," i.e., regulations promulgated during related litigation.[27] For this part, *Mayo* was certainly beneficial, with the Treasury and Service, holding that "… we have found it immaterial to our analysis that a 'regulation was prompted by litigation.'"[28] It seems that, after *Mayo,* taxpayers have more reasons to be concerned, at least in regards to final regulations.

Nevertheless, the Supreme Court in *Mayo* took a significant step towards clarifying Federal tax procedure on the one hand, and providing consistency of tax law with other areas of law on the other. From now on, courts will have to use *Chevron* deference when interpreting statutory ambiguities, while taxpayers will have to find more creative ways to challenge and disqualify Treasury regulations.

Yet, tax law is far from being similar to any other area of law. Since *temporary regulations* are issued without a notice and comment and in some cases even during a related litigation, some courts were uncomfortable providing *them* with the same level of deference as to *final* regulations. As a result, we are back to the same problem of inconsistency, but this time, concerning temporary regulations.

We probably have to wait a little longer for the completion of *Chevron*'s 'revolution' by the Supreme Court. Until then, when it concerns temporary regulations, keep *Muffler* factors along with Oxford dictionary in mind.

About the Author

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Endnotes

1 *Mayo Foundation v. United States,* 131 S. Ct, 704, 178 L. Ed. 2d 588 (2011)[hereinafter *Mayo*].

2 I.R.C. §7805(a); There are also "specific authority" regulations that empower the Treasury Department to promulgate regulations that may go beyond the mere interpretation of the statute, i.e. drafting new rules and duties; I.R.C. §§ 1017(b)(1), 1502 and §6103 that deal with discharge of indebtedness issues, consolidated returns and confidentiality of tax returns. *See also* Camilla E. Watson and Brookes D. Billman, Jr., Federal Tax Practice and Procedure, Cases Materials and Problems (2nd ed. West, 2012) p. 13 [hereinafter *Federal Tax Practice*].

3 *Mayo, infra* note 1; *National Muffler Deal-ers Assn., Inc. v. United States*, 440 U. S. 472 (1979)[hereinafter *Muffler*]; *see e.g., United States* v. *Cleveland Indians Baseball Co.*, 532 U. S. 200, 219 (2001); *Cottage Savings Assn.* v. *Commissioner*, 499 U. S. 554, 560–561 (1991).

4 *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 845 (1984) [hereinafter *Chevron*]; *See e.g., United States* v. *Boyle*, 469 U. S. 241, 246, n. 4 (1985); *Atlantic Mut. Ins. Co.* v. *Commissioner*, 523 U. S. 382, 387, 389 (1998).

5 26 C.F.R. § 31.3121(b)(1)-2(d)(3)(iii), the Treasury Department's (TD) Full-time Employee Rule.

6 *Muffler, infra* note 3.

7 *Mayo Found. for Med. Educ. & Research v. United States,* 568 F.3d 675 (8th Cir. Minn. 2009); *E.g.,* 2011 Tax Notes Today 8-10 (Jan. 12, 2011).

8 *Mayo, infra* note 1.

9 *Chevron, infra* note 4.

10 *Id,* at 842-843.

11 *Id.*

12 *Muffler, infra* note 3.

13 McMahon Martin J. Jr., Shepard Ira B. Simmons Daniel L, *Recent Developments in Federal Income Taxation: The Year 2010*, Fla. Tax Rev. 10, 565 (2011).

14 *Chevron, infra* note 4, at 843.

15 *Federal Tax Practice, infra* note 2, at 13.

16 *Chevron, infra* note 4, at 292.; *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (U.S. 2012).

17 *See Home Concrete,* 132 S. Ct. 1836.

18 2011 Tax Notes Today 90-7 (May 10, 2011).

19 *Id.*

20 Gilbert Rothenberg, appellate section chief in the DOJ's Tax Division, 2011 TAX NOTES TODAY 90-7 (May 10, 2011).

21 Pub.L. 79-404, 60 Stat. 237; Under the Administrative Procedure Act of 1946, agencies that are engaging in an "informal" rulemaking have to give the public notice and an opportunity to comment on the proposed rules with the exception of "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice." *See also* Kristin Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727, 1730 (2007).

22 Leandra Lederman, *The Fight Over 'Fighting Regs' And Judicial Deference In Tax Litigation*, 92 B.U.L. Rev. 643, 664. [hereinafter *Fighting Regs*].

23 *Id.*, at. 682.

24 *Id*; *See also Beard v. Comm'r*, 633 F.3d 616, 2011 U.S. App. LEXIS 1575 (7th Cir., 2011).

25 *Fighting Regs, infra* note 22.

26 *Federal Tax Practice, infra* note 2, at 24; Alan Horowitz, *Supreme Court Opts for Chevron Analysis of Treasury Regulations, Discarding the Traditional National Muffler Dealers Analysis*, Tax Appellate Blog, Jan. 11, 2011; *Available at*: http://appellatetax.com/2011/01/11; *See also Home Concrete*, infra note 16; *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.,* 545 U.S. 967 (2005).

27 *Id; Fighting Regs, infra* note 22, at 674.

28 *Mayo*, infra note 1; *Smiley v. Citibank (South Dakota),* N. A., 517 U. S. 735, 740 (1996).