

**NEWSLETTER OF THE
COLORADO BAR ASSOCIATION, TAX SECTION**

Report on the National Association of State Bar Tax Sections
28th Annual Meeting
October 26 and 27, 2007
By Eric J. Zinn
Brownstein Hyatt Farber Schreck P.C.
Tax Section President

The National Association of State Bar Tax Sections (the "Association") held its 28th annual meeting in Washington, D.C., on October 26th and 27th. I attended on behalf of our tax section and met with representatives of various state bar tax sections to discuss a wide variety of state and federal tax issues.

The Association's purpose is to provide a forum for the tax committees and sections of state and local bar associations. Attendance at the annual conference is limited to leaders of tax sections that are Association members. A large number of state bar associations were represented at this year's conference. The conference featured speakers and written materials on the topics summarized below.

Ethical and Malpractice Issues related to the Multijurisdictional Practice of Law.

William Freivogel of Chicago, Illinois and John Coalson of Alston & Bird in Atlanta, Georgia moderated a discussion on ethical and malpractice issues related to the multijurisdictional practice of law. During the course of that discussion, they presented an August 2002 report from the Commission of Multijurisdictional Practice of the American Bar Association and an article by William Barker entitled "Extrajurisdictional Practice by Lawyers." Mr. Freivogel noted that most lawyers have unwittingly violated various state laws regarding the prohibition on the practice of law by lawyers not licensed in a particular state. He noted that admittance "pro hac vice" can solve some issues relating to a multijurisdictional practice of law, but also noted that its general restriction to a particular case or instance is not helpful to lawyers handling numerous client matters in a jurisdiction for which they have not been admitted to practice law. Mr. Freivogel also discussed the difficulty of collecting fees for matters in jurisdictions where the practicing lawyer may not be admitted. Additionally, Mr. Freivogel noted, for state income tax purposes, the apportionment of fees earned by an attorney with a multijurisdictional practice among the various states in which he or she provides legal services. Mr. Freivogel has a website discussing in greater detail the issues he presented at <http://freivogelonconflicts.com/>.

Patenting Tax Strategies. Denis Drapkin of Jones Day in Dallas, Texas, William Prugh of Shugart, Thomson & Kilroy in Kansas City, Missouri and John Barrie of Bryan Cave in Washington, D.C. moderated a panel on the patenting of tax strategies. In addition, they presented an article by Lucas Osborn and Jim Repass entitled "Patently Illegal: What Taxpayers Should Know about Patented Tax Strategies" and an application for a tax patent by Edward Lazear and Alexandre Ziegler relating to a system and method of multistate tax analysis. The moderators noted that various legislative proposals relating to restrictions on the use of tax

patents are winding their way through Congress. A House proposals bans tax patents while a Senate proposal bans the enforcement of tax patents. Unresolved issues relating to tax patents include those concerning whether or not a patent holder becomes a tax advisor for purposes of Circular 230 and whether the client for whom an attorney develops a "patentable" tax strategy has any ownership rights to the intellectual property underlying the patent.

FIN 48. Arthur Rosen of McDermott Will & Emery in New York, New York and William Backstrom of Jones, Walker, Waechter, Poitevant, Carrère & Denègre in New Orleans, Louisiana moderated a discussion on FIN 48. As part of a round-table discussion, the moderators asked participants at the seminar to discuss any issues with which they were presented relating to the application of FIN 48 to their respective clients and practices.

NCCUSL Review of UDITPA (the Uniform Division of Income for Tax Purposes Act). Charles Trost and Michael Yopp, both of Waller Lansden Dortch & Davis of Nashville, Tennessee, and Joe Huddleston, the Executive Director of the Multistate Tax Commission in Washington, D.C. moderated a discussion on UDITPA. Most states have chosen the approach set forth in the UDITPA. The focus of UDITPA is the determination of whether the acquisition, management, and disposition of tangible and intangible property used to produce income is an integral part of the taxpayer's regular trade or business. The discussion focused on UDITPA's Section 17 and intangibles as part of the sales factor under UDITPA. It was noted that certain terms, such as "income producing activity" and "costs of performance," are undefined in UDITPA and have caused problems in UDITPA's application.

Bar Activities. Mark Sommer of Greenbaum Doll & McDonald in Louisville, Kentucky moderated a round-table discussion on various activities being conducted by the state bar tax sections in attendance at the Association meeting.

State Jurisdictions to Tax; Combined Reporting . Arthur Rosen of McDermott Will & Emery in New York, New York and Terry Polley of Ajalat Polley & Ayoob in Glendale, California moderated a discussion on jurisdictional issues and combined reporting. It was first noted that many states are moving toward the implementation of state tax courts designed specifically to handle state and local tax issues. The discussion also focused on issues of "physical presence" and "economic presence" as standards for which states acquire nexus for purposes of taxation. Issues of combined reporting related to the application of the unitary business doctrine and the development of "national spreadsheets" to divide a business' activities and related income across the various jurisdictions in which it operates.

Current Developments in the Office of Professional Responsibility. Michael Chesman, the Director of the IRS Office of Professional Responsibility in Washington, D.C. and John Barrie of Bryan Cave in Washington, D.C. moderated a discussion on the application of Circular 230 (the "Circular") and penalties. It was noted that the penalty standards applicable to clients and to tax advisors are different, i.e., "realistic possibility" v. "more likely than not." In this regard, it is anticipated that the lower standard for clients will be moved up to the higher standard for tax advisors. It was also noted, pursuant to Notice 2007-39, the IRS is authorized to provide monetary penalties for violations under Circular 230. Those monetary penalties are not intended to apply to "footfalls" but are instead directed toward egregious or repetitive bad behavior.

Important Tax and Related Developments Involving Non-Profit Organizations. Patricia Read, Senior Vice President of The Independent Sector in Washington, D.C., Michael Clark, the Chair of the ABA Tax Section Exempt Organizations Committee, Michael Yopp of Waller, Lansden Dortch & Davis in Nashville, Tennessee, and Richard Tomeo of Robinson & Cole in Hartford, Connecticut moderated a discussion on recent tax and related developments involving non-profit organizations. The discussion focused on the recent changes to IRS Form 990 and whistle-blower obligations for non-profits.

Hot Topics. Pater Faber and Arthur Rosen, both of McDermott Will & Emery in New York, New York, moderated a discussion on "hot topics" in the state taxation arena. As part of this discussion, Mr. Faber presented his outline entitled "State Tax Litigation: A National View." The discussion focused on state tax cases dealing with economic nexus, attributional nexus, passive investment companies, and sales and use tax nexus.

[SUMMARIES OF SELECTED TAX CASES AND OTHER ANNOUNCEMENTS]

Colorado Court of Appeals

City's Tax Applies to Fees Paid by Cinema For Use of Distributors' Motion Picture Reels

On February 21, 2008, a Colorado Court of Appeals ruled that a cinema operator's use of motion picture film reels for display to the public for profit was subject to the use tax imposed by the city of Fort Collins, Colo. (*Cinemark USA Inc. v. Seest*, Colo. Ct. App., No. 06CA2549, 2/21/08).

The Fort Collins city use tax statute provides that the tax is paid by either the retailer or consumer on the full purchase price paid for or acquisition costs of tangible personal property and taxable services brought into the city for the purposes of using, storing, distributing, or consuming such property and services. The city determined that the movie theater Cinemark USA Inc. operated in the city was subject to the tax and the district court upheld the assessment.

Cinemark regularly enters into agreements with film distributors whereby it obtains temporary possession of copies of copyrighted motion picture film reels and a limited license to use and exhibit the films to the public for a certain period of time. In return for such use, Cinemark pays the film distributor a designated percentage or royalty from ticket sales and, if a movie does not bring in any ticket sales, then the company pays only a nominal handling charge.

Judge Janice Davidson wrote that the plain language of the city's use tax ordinance does not offer guidance in calculating the use tax on the exhibition of by Cinemark; therefore, the court must examine the totality of the circumstances to determine the true purpose or object of its transactions with its distributors.

Judge Davidson held that "contrary to Cinemark's contention, however, we conclude that the totality of the circumstances shows that the clear purpose of Cinemark's transactions with the

film distributors is Cinemark's use of a physical product, the motion picture film reel, and that this purpose renders the transactions taxable events."

Sales, Use Tax Exemption Should Apply To Church-Affiliated Retirement Community

On September 6, 2007, the Colorado Court of Appeals reversed a trial court's judgment that denied a sales and use tax exemption to a religious-based organization for its retirement community (*Catholic Health Initiatives Colorado d/b/a Villa Pueblo Towers v. Pueblo, Colo.*, Colo. Ct. App., No. 05CA2432, 9/6/07).

Catholic Health Initiatives Colorado owns and operates Villa Pueblo Towers, a continuing care retirement community in Pueblo, Colorado. Towers provides different levels of care for elderly residents, including general elder support, assisted living, and skilled nursing care.

Catholic Health applied to the city for a sales and use tax exemption as a charitable and religious organization but the application was denied. The city audited Catholic Health and issued a notice of assessment.

On appeal, the executive director of the Colorado Department of Revenue found that the exemption for religious or charitable organizations did not apply and the city was entitled to its assessment.

The trial court found that the First Amendment rights of the Catholic Church did not preclude collection of the sales and use tax. The court further ruled that the religious exemptions will apply to regularly related religious functions and other than that, for all secular functions, Villa Pueblo must pay sale and use tax to the city when applicable.

The appeals court examined the city of Pueblo's municipal code and found that certain classes of tangible personal property are among those exempt from the sales or use tax.

The term "charitable organization" under the municipal code included any entity that had been certified as a not-for-profit organization under Internal Revenue Code Section 501(c)(3) and was a religious or charitable organization, the court of appeals found.

Although the definition of religious activity was not in the city's code, the court of appeals examined the Colorado Supreme Court case of *Maurer v. Young Life*, 779 P.2d 1317 (Colo. 1989), which addressed whether a religious organization was exempt from property taxation under Colorado's property tax provisions.

Applying the principles set out in *Maurer* and some other cases, the court of appeals found that Tower's operation was a religious activity or function.

The parties had stipulated that Catholic Health is a religious organization affiliated with the Catholic Church, that it operated at a loss from July 1997 to May 2004, and that its activities are religiously motivated. The parties also stipulated that Catholic Health provided services

consistent with its mission and the use to which the property was put is consistent with Catholic Health's sincerely held religious beliefs.

Further, the parties stipulated that the use of the property for religious worship and reflection is integrated into Tower's daily activities, its managers are trained regarding the religious mission and ministry, the employees are instructed and required to support that mission, and that Towers holds itself out as a religious organization, the court of appeals said.

The court found that the entire operation of Towers was a religious activity and that the exemption for the property should have been granted.

Tenth Circuit Court of Appeals

10th Circuit Finds Taxpayer's Appeal Frivolous

The U.S. Court of Appeals for the 10th Circuit found Charles Raymond Wheeler's pro se appeal of a U.S. Tax Court decision to be frivolous, affirming the Tax Court's decision but denying the Internal Revenue Service's motion for sanctions (*Wheeler v. Commissioner*, 10th Cir., No. 07-9005, 4/10/08).

Most of the allegations in Wheeler's petition to the Tax Court were unintelligible or, if intelligible, were frivolous. At a pretrial conference, the court warned Wheeler several times about his arguments and that if he continued to trial using the frivolous arguments the court would consider imposing a penalty.

The Tax Court assessed a \$3,854 deficiency in Wheeler's income for the 2003 tax year, assessed an addition to tax of \$765 for failing to file a return for the 2003 tax year, and ordered him to pay a \$1,500 penalty for pursuing frivolous and groundless arguments and for maintaining court proceedings primarily for delay.

United States Tax Court

Tax Court Upholds Notice of Tax Lien

On February 12, 2008, the U.S. Tax Court found no grounds on which to overturn a notice of federal tax lien against Robert Scharringhausen, who filed income tax returns, but did not always pay the tax due (*Scharringhausen v. Commissioner*, T.C., No. 4427-06L, T.C. Memo. 2008-26, 2/12/08).

Scharringhausen's history of not paying his taxes reaches back at least to the early 1990s. There is an outstanding judgment against him for nearly \$500,000 for unpaid income taxes for 1991 and 1992, and for trust-fund-recovery-penalty taxes for 1990 and 1991. He and some of the firms he controlled also had other problems, and later in the decade he served a short sentence for bankruptcy fraud. After being released, he went back into business, but failed to file returns in 1999 and 2000. See *Scharringhausen v. United States*, 91 AFTR 2d 651, 2003-1 USTC par. 50,224 (S.D. Cal. 2003) (enforcing summons for records of offshore credit card use).

Tax Court Upholds IRS Rejection of OIC-DATL When Notice of Deficiency Not Challenged

The U.S. Tax Court Dec. 27 issued an opinion holding that the Internal Revenue Service did not abuse its discretion when it rejected an offer in compromise based on doubt as to taxpayer liability because Section 6330(c) bars taxpayers who did not challenge a notice of deficiency from challenging their underlying tax liability after receiving a notice that a federal tax lien had been filed on their property (*Baltic v. Commissioner*, T.C., No. 2826-06L, 129 T.C. No. 19, 12/27/07).

Peter and Karen Baltic made their offer in compromise based on doubt as to liability (OIC-DATL) just as IRS was poised to begin seizing their property, and after they had the chance to contest their liability in court. Section 6330 of the Internal Revenue Code says that taxpayers like the Baltics cannot challenge their underlying tax liability, Judge Mark V. Holmes explained:

“The purpose of a [collection due process] hearing is to balance the government’s requirement for effective tax administration with the taxpayer’s concern that collection be minimally intrusive. By deciding to hold off on collection by levy but preserve the government’s lien priority while other employees of the IRS considered the Baltic’s OIC-DATL and various late-filed returns, the Commissioner exercised discretion in a completely reasonable way.”

Retirement Association Payments Not for Disability

The U.S. Tax Court ruled that payments received by George Tateosian from the Public Employees Retirement Association of Minnesota were not disability payments and must be included in his 2003 gross income and that he was not liable for an accuracy-related penalty under Section 6662 of the tax code (*Tateosian v. Commissioner*, T.C., No. 13019-05, T.C. Memo. 2008-101, 4/16/08).

Tateosian, a police officer, was injured in the line of duty in 1955 and began receiving disability payments. The court found that, following a change in Minnesota law, his disability benefits were terminated and he was deemed a service pensioner, which meant the payments he received could no longer be characterized as compensation for personal injuries.

Additionally, the court found that, based on Tateosian’s education, background, and the complexity of the statutory scheme in the case, he acted in good faith based on his understanding of state law and, therefore, he was not liable for an accuracy-related penalty.

IRS/Department of Revenue Announcements

IRS Announcement 2008-7 on Marketing of Refund Anticipation Loans

This document describes rules that the Treasury Department and the IRS are considering proposing, in a notice of proposed rulemaking, regarding the disclosure and use of tax return information by tax return preparers. The rules would apply to the marketing of refund anticipation loans (RALs) and certain other products in connection with the preparation of a tax return and, as an exception to the general principle that taxpayers should have control over their tax return information that is reflected in final regulations published in T.D. 9375 which is published elsewhere in this issue of the Bulletin, provide that a tax return preparer may not obtain a taxpayer's consent to disclose or use tax return information for the purpose of soliciting taxpayers to purchase such products. This document invites comments from the public regarding these contemplated rules. All materials submitted will be available for public inspection and copying.

**COLORADO BAR ASSOCIATION TAX SECTION TOPICAL LUNCHEONS
(Tentative Schedule)**

Date	Speaker(s)	Topic	Location
May 14, 2008	Michael Stiff, Esq	Estate Planning 2008- What's Hot, What's Not	Warwick Hotel
June 11, 2008	TBD	2008 Annual Legislative Update	Warwick Hotel

COLORADO BAR ASSOCIATION, TAX SECTION

Newsletter Editors

Rob Keyser
Hank Vanderhage

Council Officers

Chair	Eric Zinn
Vice-Chair	Neil Pomerantz
Treasurer	Steven Weiser
Secretary	Rachel James

Council Members

Andrew Kroll
Stuart Sargent
Hank Vanderhage
Andrew Elliot
Robert Keyser
John Warnick

Section Committees and Chairs

Education Committee

	Stuart Sargent
A. CLE	Gary Abrams
B. Topical Lunches	Stuart Sargent
C. Pro Bono	Stuart Sargent/Susan Lindley

Legislative Committee

A. Federal	Adam Cohen
B. State	Michael Valdez

Publications Committee

	Rachel James
A. Newsletter	Hank Vanderhage/Rob Keyser
B. Tax Tips	Rachel James/Adam Cohen/Steven Weiser
C. Website	Eric Zinn

Agency Positions Committee

Neil Pomerantz

Interprofessional Committee

	Eric Zinn
A. IRS Liaison	Adam Cohen
B. ABA Report	Adam Cohen
C. Section Liaisons	
Business:	
Trusts & Estates:	Andrew Kroll
Real Estate:	Andrew Elliott

CBA Staff Liaison

Erica Driver