

# TAX TALK

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• Katrina Kamantauskas-Holder, *Chair* •

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## FROM THE CHAIR

By Katrina Kamantauskas-Holder

As Chair of the Tax Section, I have spent the past 10 months enjoying a unique “behind the scenes” look into what goes into creating the MSBA community. I would like to take this opportunity to recognize the many sung and unsung heroes I have had the pleasure of working with this year.

I’ll start globally, with the MSBA. Behind every service, event and connection that the MSBA provides to its members are real people who work extremely hard to make everything conveniently and magically appear. MSBA President Tom Murphy, Executive Director Paul Carlin, the Section Chairs, the Board of Governors, and the Planning Committee all contribute vision and structure to the organization to move it forward and address the members’ wants and needs. And without the efforts of the MSBA staff, all of what we currently take for granted would disappear. I would like to personally thank Janet Eveleth, the Director of Communications, for her efforts over the decade on the Maryland Bar Journal and other publications, John Anderson, Website Coordinator, for our Tax Section website, Pat Yevics and Patrick Tandy for their clockwork Bar Events, Bar Brief and Bar Bulletins, Andrea Terry for orchestrating the CLE programs, and Theresa Michael for the thankless but necessary tasks of arranging meetings, printing name tags, and collecting money.

On a more intimate note, I would like to thank the 25 members of the Tax Section Council, who have shared their time, energy, and expertise to keep the Tax Section meaningful and relevant to its membership. Particular kudos go to Caroline Ciruolo and Robb Longman for the U.S. Tax Court Pro Bono program, to Jeff Markowitz for his perseverance in keeping “Maryland Taxes” alive, and to Paul Marcotte, king of webinars. In addition, a special thank-you and recognition goes

to our unsung hero, Jennifer Pratt, for her efforts in pulling together all the arrangements for both Tax Networking Night and the Shulbank Dinner. And finally, not to be forgotten are our State Legislation co-chairs, Steve Gevarter and Herman Rosenthal, who essentially have been on-call for the entire legislative session.

Focusing further, I would like to express my appreciation to the Study Group chairs, who hardly ever get the recognition they deserve. So please, a big round of applause for Jennifer Pratt (Estate and Gift Tax), Diana Gary and Brian Della Rocca (Montgomery County/Prince George’s County Tax), Gary Hyman (State Tax), David Polashuk (Tax Controversy), and Jon May (Tax-Exempt Organizations and Transactional Tax). The next time you learn something from another lawyer or a government speaker, or realize that there are bagels when you are hungry, thank your Study Group chair.

*(continued on Page 2)*

## TABLE OF CONTENTS

Pg. 2

Settling Tax Litigation With the  
United States: Pitfalls and Prescriptions

Pg. 4

The Supreme Court  
Finally Confirms that Taxes  
(and Tax Lawyers) Are Not Special

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# Settling Tax Litigation with the United States: Pitfalls and Prescriptions

*By John B. Snyder, III*

Most tax controversy litigation is resolved by settlement. However, the United States, whether represented by the Department of Justice, Tax Division in the Article III and bankruptcy courts or the IRS Office of Chief Counsel in the U.S. Tax Court, approaches settlement differently from private litigants. Settling with the United States can be a perplexing and frustrating process for those unused to dealing with the government. This article provides an overview of the quirks of the United States' approach to settlement, as well as a few tips for navigating the settlement process.

Unlike other large, institutional parties, the United States' policies on settlement are governed by statute, 26 U.S.C. § 7122, and related regulations promulgated by the Justice Department and the Service. These provide for settlement on two bases. First, cases may be settled based on doubt as to liability, the possibility that the taxpayer is not liable for the tax at issue. Second, they may be settled based on doubt as to collectability. That is, even if the taxpayer is fully liable under the law, financial circumstances render it impossible for the taxpayer to pay in full. The IRS may settle on a third basis, effective tax administration, which largely overlaps with doubt as to collectability in most cases where it is relevant. Both doubt as to liability and doubt as to collectability are usually determined with regard to the "hazards of litigation." That is, the more difficult it will be for the government to win the litigation, the more likely the settlement. The United States takes these limits on settlement seriously and does not deviate from them. The government views them, not unreasonably, as mechanisms for guaranteeing that it fulfills its mission to the public fully and fairly.

Practitioners should also recognize what the settlement rules do not include. The United States will not, and, under the law, cannot, settle for other reasons. The United States won't settle simply for sake of settlement or for "nuisance value." Unlike a private party, the United States will not settle a case based on the expenditure of time and resources. Nor will it settle just because the dollar amount to be collected if it wins the case is low.

This can lead the government to take positions that seem needlessly doctrinaire or even irrational to a private practitioner. For example, imagine a refund suit brought by a low-income taxpayer to recover \$3,000. A private institutional litigant

might simply concede such a case, based on the low potential payoff and the bad press of such a "David and Goliath" situation. An inexperienced practitioner might point this out to government counsel, then be shocked to have the proposed concession rejected. Unless it is presented with an argument for settlement on one of the bases discussed above, the United States will defend the suit just as vigorously as one involving a thousand times as much money. The government is doing this not to punish the low-income taxpayer and his attorney, but to comply with its obligations under the law.

Additionally, unlike other litigants, the United States does not make settlement offers. From the government's point of view, once a case reaches a judicial forum, its duty is to see the dispute fairly resolved, not simply to dispose of the case. Thus, it will not undercut itself by offering to settle a case for less than its full value. Rather, it is the taxpayer's responsibility to initiate the settlement process.

Further, settlement authority within the government is dispersed among many individuals. Who, exactly, has final authority to settle a taxpayer's case varies based on the agency involved, the amount at issue, the type of case, and many other factors. Most significantly for taxpayers' representatives, line attorneys handling cases for the United States do not have final settlement authority. However, line attorneys' opinions are given significant weight in settlement decisions. Persuading the line attorney that settlement is in the government's best interest is critical to obtaining an effective settlement.

Knowing these policies and shaping one's settlement practice with them in mind renders settling with the United States much simpler and less painful. Practitioners can put this knowledge to use in several, related ways.

First, don't expect the United States to make you a settlement offer, even in affirmative collection litigation brought by the government. Starting the settlement process, including determining how much to offer, is your responsibility as a taxpayer's representative.

Second, a dollar figure alone is not enough. Give the government a reason to settle. This sounds obvious, but many attor-

*(continued on Page 3)*

## TAX LITIGATION...

(continued from Page 2)

neys overlook it. Settling with the government is not a purely numerical, bid/counterbid process. A reasoned basis for your offer, even one as simple as, "My client can't afford to pay," renders your argument for settlement much more persuasive than simply throwing out a number. Further, it gives the government line attorney handling your case a basis on which to persuade superiors with settlement authority that settlement is in the government's best interest.

Finally, make the reason to settle conform with the government's settlement policies. When making an offer to the United States, make sure it can be categorized as being based on either doubt as to liability or doubt as to collectability. For instance, in the low-income taxpayer case mentioned earlier, rather than arguing, "The government should give up this case because it's unfair to the client and because \$3,000 won't even cover the cost of defending the suit," counsel could argue that the client lacks the funds to pay the liability, an argument based on doubt as to collectability. Alternatively, counsel might reframe the argument about unfairness as, "If the case goes to trial, the jury will be more sympathetic to my impoverished client than to the government. The United States runs the risk of a finding that the taxpayer isn't liable at all." This turns an abstract argument about fairness into one based on doubt as to liability.

Settling with the government is not like settling with a private party. However, an understanding of the United States' settlement policies and the tips discussed in this article can transform it from an exercise in frustration to an effective means of getting satisfying results.

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## LETTER FROM THE CHAIR...

(continued from Page 1)

And finally, I would like to recognize this year's award winners. The recipient of the Tax Excellence Award is Fred Brown, Director of the Graduate Tax Program and Associate Professor at the University of Baltimore School of Law. Fred has done a first-class job teaching, making the Graduate Tax Program happen, and giving back to the legal community, including a stint as director of the UB Tax Clinic and a term on the Tax Section Council. The J. Ronald Shiff Memorial Pro Bono Award is being given to the Baltimore Office of Chief Counsel, Internal Revenue Service Small Business/Self-Employed Division. Lawyers familiar with tax pro bono work have commended this office for coordinating taxpayers needing pro bono tax representation with lawyers willing to provide such services, through the Tax Court pro bono program and otherwise, and generally being willing to help ensure that taxpayers have adequate legal assistance and representation when involved in conflicts with the IRS.

With that, I would also like to thank all of the Tax Section members for allowing me the privilege to serve as your Chair this past year. Don't forget the annual meeting in Ocean City on June 10, and enjoy your summer!

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sections/taxation](http://www.msba.org/sec_comm/sections/taxation)

Have you visited the Tax Section website  
lately?

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Comments, contributions, and suggestions are greatly appreciated. Please direct them to the Editor.

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# The Supreme Court Finally Confirms That Taxes (and Tax Lawyers) Are Not Special

By Michael J. Salem

“... [Y]ou are not so different from other people so don't give yourself airs . . . .”

“Don't think you're special because you're not.”<sup>1</sup>

## Introduction

Taxcentrism<sup>2</sup> took a hit in early January with the Supreme Court's decision in *Mayo Foundation for Medical Education & Research v. United States*<sup>3</sup>. In *Mayo Foundation*, the Court dealt with two important issues that had been extant in tax law for some time.

Of shorter duration and more limited application was the lingering question whether medical residents, and perhaps by extension other professional apprentices as well, were required to be treated as wage-earning employees by medical schools and teaching hospitals. The second question addressed in *Mayo Foundation* was the well-known but sometimes unacknowledged differential treatment by the courts of tax regulations vis-a-vis all other types of federal regulations. The Court, writing through Chief Justice Roberts, held that medical residents, at least since April 1, 2005, are “employees” within the meaning of 26 U.S.C. § 3121, and more importantly, that notice and hearing regulations dealing with taxation are to be interpreted and evaluated in the same way as all other federal regulations.

## Background of the Case

That both of these issues were joined in the same case was no coincidence. The underlying statute, 26 U.S.C. § 3121, was amended many times over the years. From 1951 on, the Internal Revenue Service generally had been successful in asserting its long-held position that medical residents were not covered by the student exception in section 3121(b)(10), and were therefore subject to FICA<sup>4</sup> tax withholding<sup>5</sup>. Until 2005, the Service had decided each question of individual coverage on a case-by-case basis<sup>6</sup>. Then, a 1998 Social Security Act case caught up with and ultimately overwhelmed tax administration. In *Minnesota v. Apfel*, the Eighth Circuit rejected the SSA's categorical treatment of medical residents as employees, based upon the SSA's own regulation requiring a case-by-case analysis<sup>7</sup>. The Apfel decision was followed by some 7,000 refund claims by medical residents and hospitals, an onslaught the IRS was not able to handle on a case-by-case basis<sup>8</sup>, especially when punctuated by

litigation reaching disparate results<sup>9</sup>. The Service responded in late 2004 with a regulation that classified persons who provided services to an employer on a normal schedule of 40 or more hours per week as employees for purposes of FICA taxes<sup>10</sup>. The new regulation contained a specific example dealing with medical residents, categorically deeming a medical resident with a normal work week of 40 or more hours per week as an employee<sup>11</sup>.

The new regulation spawned its own litigation, itself yielding differing results. *Mayo Foundation* began as a refund suit in the Minnesota district court, in which the trial court granted summary judgment against the validity of the IRS' new regulation<sup>12</sup>. The district court held that the text of the statute unambiguously granted exempt status to medical residents, and went on to invalidate the regulation under the standards of *National Muffler Dealers Assn., Inc. v. United States*<sup>13</sup>. The reliance upon *National Muffler* added a second dimension to the case, since the proper standard for evaluating tax regulations had been confused for a number of years<sup>14</sup>. The Supreme Court granted certiorari<sup>15</sup>.

## Is the Statutory Exception for Students Ambiguous?

The Supreme Court had little difficulty deciding that 26 U.S.C. § 3121(b)(10)'s student exception from FICA taxes was ambiguous. It began its analysis with the first of the two steps for review of federal regulations announced in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*<sup>16</sup> The first *Chevron* step asks “whether Congress has ‘directly addressed the precise question at issue.’” Chief Justice Roberts summarily stated that “The statute does not define the term ‘student,’ and does not otherwise attend to the precise question whether medical residents are subject to FICA.”<sup>17</sup> With that narrowly drawn question—and almost ineluctable resulting ambiguity—the Court proceeded to the second *Chevron* step, with only a rather terse detour to resolve the *National Muffler/Chevron* controversy.

## A Short Detour for Clarification

The Court acknowledged the tax regulation controversy engendered by *National Muffler* by noting that in “the typical case,” the next item to address would be *Chevron* step two, which asks if the agency rule is “arbitrary or capricious in

(continued on Page 5)

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## SUPREME COURT...

(continued from Page 5)

substance, or manifestly contrary to the statute.” But because of the petitioner’s and amici’s insistence on the *National Muffler* standard for tax regulations, the Chief Justice thought it necessary to address the question of which standard of review was applicable.<sup>18</sup>

The Court concluded that the Chevron framework, which the Court had reiterated in *United States v. Mead Corp.*<sup>19</sup> in 2001, was the proper analysis for tax regulations as well as other federal regulations. While acknowledging the conflicting decisions on the question that had issued from the Court since *National Muffler*, the Court gave no real reason for the differences in the analytical approaches of *National Muffler* and *Chevron*.<sup>20</sup> Instead, Chief Justice Roberts simply stated that there was no reason to differentiate between tax regulations and other federal regulations, pointedly and ostensibly basing this conclusion on Mayo Foundation’s failure to “advance[] any justification for applying a less deferential standard of review to Treasury Department regulations than we apply to the rules of any other agency.”<sup>21</sup>

### **The Regulation Is Valid**

Having thus disposed of the National Muffler/Chevron controversy, the Court, again without any difficulty, concluded that the regulation was neither arbitrary and capricious, nor was it manifestly contrary to the statute.<sup>22</sup>

### **Conclusions & Collateral Damage**

With those few paragraphs, so died the myth of tax regulations—and by extension taxes and tax lawyers—as exceptional, different, or special among their legal peers. It seems clear after *Mayo Foundation* that the federal courts are to review tax regulations, whether general authority or specific authority in genesis, in the same deferential way as other federal regulations. Under *Chevron*, the courts first should ask whether the statute addresses the precise question in litigation. If the answer is no, then the second question is whether the regulation is arbitrary and capricious, or manifestly contrary to the statute. If that question is also answered in the negative, then the regulation stands.<sup>23</sup>

As for medical residents, the pre-regulation cases will proceed to administrative resolution, unaffected by *Mayo Foundation*, based on an IRS administrative decision to accept the position that medical residents are excepted from FICA taxes for tax periods ending before April 1, 2005.<sup>24</sup> For post-regulation case, *Mayo Foundation* will have a dispositive effect. All medical resident cases involving tax periods commencing on and after April 1, 2005 should go to the IRS, barring some unforeseen factual aberrations in individual cases.<sup>25</sup>

The wider and more long ranging effect of the decision, however, is the Court’s repudiation of taxcentrism, by clarifying how federal courts are to review tax regulations, and even to some extent other federal regulations. *Mayo Foundation* will have a wide and deep impact, far beyond the confines of the medical resident cases. Already, *Mayo Foundation* has been cited in this regard six times by the federal courts of appeals, with our own Fourth Circuit producing half of the citations.<sup>26</sup>

As for the egos of tax lawyers, we can only speculate on the damage done to the subculture of tax geeks and quasi-CPAs by the unceremonious stripping away of their perceived “specialness.” Perhaps the decision may even have the opposite effect, conferring a patina of normalcy upon tax practice and raising the self- and public images of tax lawyers to that of—dare we flatter ourselves to say it—litigators. For now, the tax bar will have to comfort itself with a clarification of the law that was long in coming, but at least in its immediate aftermath, seems to have provided clear guidance on how to approach IRS regulations.

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