The 2015 Erwin N. Griswold Lecture Before the American College of Tax Counsel: A Remembrance of Things Past and Speculation About the Future of Tax Administration

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Shortly after I returned to private practice from the Office of Chief Counsel in 1983, I was invited to join a group of tax lawyers who met for lunch in Washington at the Sheraton Carlton and then the Jefferson Hotel on the first Monday of each month. The group had been founded in 1959 by Gene Bogan and included at least ten members who had been or would be Tax Section Chairs and more than a dozen who had held high government office. Erwin Griswold, the former Dean of Harvard Law School and former Solicitor General, was an active member and regular participant, still practicing tax law at age 80 and beyond. This lectureship is a fitting memorial to a distinguished lawyer whose contributions to our country ranged far beyond the tax law but whose interest in and devotion to tax law always remained a central focus of his remarkable career. The Bogan lunch group dissolved long ago, and many of its members are no longer with us. But it brings a smile to my face to think of them sitting around the table swapping professional gossip with humor and debating serious tax policy and the Service's new positions with courtesy and real engagement.

Now I am the one whose practicing career is far closer to its end than its beginning, and I wonder what they would have thought about the current state of tax law and tax administration. This evening, I am going to exercise an old guy's prerogative and ramble a bit about some topics that are, and have long been, concerns of mine: the quest for administrable rules, the effective demise of section 7805(b) relief, the partnership audit rules, and integration of the corporate and personal income taxes. I make no claim to objectivity—whatever that might be with respect to a revenue system in which we are all participants—but the views that I will express tonight arise from many years of active engagement in the tax system both in and out of the Government. I'll try not to be sleep-inducing, and in the interest of achieving that goal, I'll also try to be brief.

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Perhaps one way to begin is to ask you to think back to the last time you heard anyone assert that we have the best tax system in the world. When the Boganeers, including Dean Griswold, held high office and led the Tax Section, that assertion was regularly made, and foreign revenue officials regularly came here to learn why. But I haven't heard anybody assert that our system is best for many years, and I suspect that you haven't either.

What changed and when did it change? More importantly, why did it change? I have no certain answers to those questions, but I think I can identify several ways in which tax administration has changed.

One of the most notable changes in the administrative landscape has been the withering away of section 7805(b) relief. Specifically, what is now section 7805(b)(8) has long provided that "[t]he Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect."

There are more specific rules now for regulations, but regulations adopted after fair opportunity for notice and comment are not really my focus this evening. What I am speaking about are "IRS positions"—the interpretation of the Code and regulations in a particular factual context. In an earlier era, the announcement of a new gloss on the application of the Code to a specific set of facts by ruling or notice would often be accompanied by a statement that the new position would be applied without retroactive effect. Nowadays such discretion is fairly narrowly confined to substantial modifications of prior published guidance or revocations of rulings and determination.

The old way was particularly useful in dealing with a situation that I believe has become more, not less, common since those days: a substantial body of practitioners had issued opinions on an interpretative issue that were contrary to the position that the Service had determined that it wished to adopt on the issue. By announcing that the Service's new position would be applied without retroactive effect, the field of controversy was always substantially narrowed and often eliminated altogether. And the results, I believe, were beneficial to the system: virtually all taxpayers complied with the new interpretation going forward, controversy resources were conserved, and by no means least, the avoided controversy fostered a better relationship between affected taxpayers and the Service.

I recognize that "going prospective" is always a judgment call; some positions have to be asserted with retroactive effect because to do otherwise could encourage aggressive and abusive taxpayer positions. But I don't believe that such a characterization is appropriate for all, and probably not even for most, novel positions the Service takes. Retroactive enforcement of novel positions, particularly in situations where the Service is aware of a large body of contrary practitioner opinion, virtually assures that there will be a large expenditure of limited controversy resources and a concomitant increase in antagonism with taxpayers. Use of those limited resources to fight about retroactive application of a position that could be adopted with little or no opposition on a

going-forward basis means that other, often more productive, opportunities for use of those resources are necessarily foregone. In addition, prospective application of novel positions recognizes the reality that there often is more than one reasonable interpretation. Good administration requires the administrator to pick one, but that choice can often be implemented without forcing a fight about the past.

I think I can make the abstractions I have been discussing concrete by discussing a couple of cases in which I personally participated. In one, the *Bobrow* case, I and others filed an amicus brief on behalf of this organization, the American College of Tax Counsel, urging reconsideration of a Tax Court opinion holding that a taxpayer could only make one rollover by distribution and recontribution between individual retirement accounts in a year, no matter how many such accounts the taxpayer had.[1] The problem was that the pamphlets the Service had issued on IRAs had said for years that the taxpayer could make such rollovers annually from each account, and there were similar private letter rulings as well. In *Bobrow*, the Service used its section 7805(b)(8) authority to achieve a Solomonic result; it stated that it would apply the narrower Tax Court interpretation—only one rollover per year per taxpayer—but only beginning about eight months in the future. This result resolved the case, but more importantly, it avoided what would likely have been messy and acrimonious controversy in other cases, while achieving a uniform and administrable result going forward.

The second example is one in which I think section 7805(b)(8) authority should have been exercised but was not—the *Anschutz* case.[2] That case involved variable prepaid forward contracts on publicly traded stock. The Service had issued Revenue Ruling 2003-7[3] holding that variable prepared forward contracts, as described in the ruling, were "forwards" and not "present sales;" that is, the taxpayer recognized income or loss when the contract matured, not at inception.

But the *Anschutz* contracts, like many, many other prepaid forwards of that era, had an additional feature not addressed in the ruling. The counterparty for such forward contracts, almost always an investment bank, did not seek to take the opposite side of the market risk imbedded in a prepaid forward. Instead, the bank wanted to hedge out its market exposure, which it did by borrowing and short-selling the listed stock to which the forward contract related. Virtually all such contracts were written on widely-traded, easy-to-borrow, market-listed names, so that the bank's cost to borrow was typically about 15-25 basis points annually. Numerous practitioners concluded—and issued opinions—that the bank could borrow the stock subject to the forward contract from the forward seller without triggering a present sale, typically

[1] Bobrow v. Commissioner, 107 T.C.M. (CCH) 1110, 2014 T.C.M (RIA) ¶ 2014-021; Announcement 2014-15, 2014-16 I.R.B. 973; Announcement 2014-32, 2014-46 I.R.B. 907.

[2] Anschutz Co. v. Commissioner, 135 T.C. 78 (2010), *aff'd*, 664 F.3d 313 (10th Cir. 2011).

[3] Rev. Rul. 2003-7, 2003-1 C.B. 363.

after some period of delay to demonstrate that the stock could be borrowed in the open market.

The Service, however, in a Technical Advice Memorandum, took the position that lending the stock subject to the forward sale contract to the counterparty bank converted the forward into a present sale, even though the stock lender (forward seller) could, and often did, recall the loaned shares without terminating the forward contract. Apparently, it would also have been fine to earn lending fees by loaning the shares subject to the forward to anybody other than the bank that was the forward counterparty. The Government prevailed in the *Anschutz* litigation, and my purpose is not to reargue the merits but simply to point out that there was an alternative to litigating, and that alternative was to make the new position on counterparty stock loans prospective—that prospective application could even have been conditioned on recalling outstanding stock loans to counterparties to demonstrate that the forward contract was independently viable. Had this occurred, I believe there would have been no controversy; the market would simply have adapted to the new position and moved on, and enforcement resources could have been used more productively.

As it ultimately turned out, only a few cases out of the thousands of prepaid forwards with counterparty stock loans were ever challenged, so in a sense, a sort of de facto prospective effect was provided for substantially all such transactions. But such an approach does little to conserve audit and litigation resources and lacks the clarity and certainty of a straightforward exercise of section 7805(b) authority. *Anschutz* illustrates yet another risk of taking the litigation route: a prospective change is limited and has few collateral effects. Litigation by its nature lacks that precision. The litigated outcome in *Anschutz* may have created as much uncertainty as it resolved.

I conclude on this topic by simply observing that more frequent use of section 7805(b) authority avoided a lot of controversy in the past and conserved a lot of controversy resources for better use. I would like to see that approach make a comeback.

There are some who think that tax law uncertainty is a good thing, but I am not one of them. This is not a new theme for me. In my 1998 Woodworth Lecture, I advocated "pragmatic compromises with theoretical income measurement norms that produce administrable rules. By administrable rules I mean rules that are understood by the taxpayers to whom they apply and that are enforceable by the Internal Revenue Service with a minimum of dispute."[4] I cited the custodian parent presumption for dependency exemptions and section 197 amortization rules for intangibles as examples of such rules. It's fair to say that the passive loss rules embodied in section 469 also belong on that list. The passive loss rules effectively ended an earlier era of tax shelters

[4]Kenneth W. Gideon, Laurence Neal Woodworth Lecture: Assessing the Income Tax: Transparency, Simplicity, Fairness, *in* Tax Law Works Best when the Rules are Clear, 81 Tax Notes (TA) 999 (Nov. 23, 1998).

and have, given the broad range of their coverage, produced remarkably little litigated controversy. Former Ways and Means Committee Chairman Camp's proposal to mark almost all derivatives to market and tax them at ordinary rates might, if enacted, prove to be another such rule. But my focus tonight is not on the desirability of any particular policy choice but rather on a broad approach to tax administration founded on ending controversy by adoption and enforcement of administrable rules.

Another label for this approach is "transparency," which the OECD once equated with setting forth "clearly the conditions of applicability to taxpayers in such a manner that those conditions may be invoked against the authorities."[5]

In 1998, I was concerned about a net loss of transparency in our income tax system that I feared was accelerating. I posed the problem then in terms of issues that regularly arise between taxpayers and the Service, "the 'uncertainty gap' is growing and the area open to negotiated outcomes is expanding."[6]

In 1998, I was concerned that the response to aggressive transactions would not be the crafting of new administrable rules like the passive loss rules to meet a new generation of challenges but instead the growing reliance on anti-abuse rules with vague parameters. In the almost two decades since, the over-reliance on anti-abuse rules has become an addiction. The list is too long to catalog in a talk like this, but I'll name a few so that it is clear what I am addressing. The partnership anti-abuse rules that I criticized in 1998 have been joined by the statutory economic substance provisions[7] and the structured passive investment arrangements (or "SPIA" rules).[8]

The basic defect of all anti-abuse rules is uncertainty. Indeed, the objective of an anti-abuse rule is the opposite of transparency; such "rules" purposely do not state the conditions under which they may be invoked by taxpayers against the authorities. The drafters of anti-abuse provisions—I hesitate to label such uncertain guides "rules"—do not seek to provide a clear determination between situations in which the rule applies to deny benefits and those in which it does not.

But somebody, someday, must decide whether the benefit sought will be allowed or denied. Anti-abuse rules push that decision down to the level of audit on a taxpayer-by-taxpayer basis. This is always resource intensive, meaning that the use of audit resources consumed in such particularized analysis cannot be devoted to broader audit coverage. Moreover, the case-by-case application of vague rules simply cannot avoid inconsistent outcomes. Worse yet, if government enforcement policy is to enforce technical Code rules when adverse to taxpayers but apply anti-abuse exceptions to such rules when the

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[5] OECD, Harmful Tax Competition: An Emerging Global Issue 28 (1998).
[6] Gideon, *supra* note 4, at 1000.
[7] I.R.C. § 7701(o).
[8] Reg. § 1.901-2(e)(5)(iv).

technical rules favor taxpayers, there is a "heads = I win, tails = you lose" result that is unlikely to satisfy anyone's notions of basic fairness and the rule of law.

It may be that we cannot do without such rules in a residual role. Anti-abuse rules, however, are not playing residual roles in tax administration today, and I would identify this deliberate shift away from clear rules and transparency as a substantial contributing reason why few of us now think that we have the best tax system in the world. I do not assign primary blame to those leaders at the Service who have advocated "vagueness" as virtue, but I do not exonerate them either. Things need to change if tax administration is to improve, and fairness demands acknowledgement that the current situation arose from many causes—notably Congresses that simply weren't doing their jobs in terms of routine Code maintenance and that remain addicted to revenue estimates attached to vague rules without adequate consideration of the impact of such resource-intensive choices on the viability of the tax system. Our courts have too frequently embraced such rules as an easy way to condemn transactions the judge didn't like without considering the adverse effect that such ad hoc decision-making must have on the transparency of our tax laws.

Tax practitioners also bear a share of the blame. Those who advocate technical positions that are at odds with anything Congress could conceivably have had in mind in enacting the provision certainly bear a large measure of responsibility for getting us where we are. That said, I firmly believe that the solution for us all is to return to the collaborative search for clear, understandable rules. If the excessive dependency on vague rules of uncertain application continues, I fear that the viability of the income tax must inevitability decline. There simply will never be enough resources for the case-by-case analysis demanded by such rules. In the absence of such massive resources, outcomes will become increasingly variable and those on the adverse side of the variability are not going to perceive the outcomes as fair. Rulemaking to achieve clear rules that seldom need to be litigated is hard work, but it is not beyond the capability of our system.

Let's turn now to a topic where I think there is a particular need to renew the search for administrable rules. There have been several recent proposals to revise the partnership audit rules that now appear as sections 6221-6234, ranging from scrapping partnership audit procedures altogether to effectively taxing partnerships as if they were corporations. As Chief Counsel in 1982, I had a ringside seat to the drafting and enactment process for the original partnership audit legislation, and recalling some of that history may be a good place to begin. In the three or so years that preceded the TEFRA legislation in 1982, the ABA Tax Section and other practitioner groups, as well as the Service itself, became concerned that the procedural audit rules for partnerships as they then existed were facilitating noncompliance in tax shelter transactions. It would probably be more accurate to say the lack of any such procedures was the problem because, in those days, partnership items were simply entries on individual returns, and unless the Service opened an audit

and adjusted every partner's return, many meritorious adjustments simply wouldn't be made. Compounding this were the interrelated issues of partnership tiering and statute of limitations control. In those days, promoters often created five or six partnership layers between the actual investment partnership vehicle and the individual taxpayers seeking tax shelter benefits. If the Service couldn't penetrate the tiers fast enough to find and control the individual statutes of limitations applicable to the shelter investors, meritorious adjustments would again be lost because the limitations period would expire before they could be asserted.

There was general recognition that something needed to be done and that any workable system would require a lot of thought and drafting effort—because we were really starting from scratch. Almost immediately after my confirmation in the summer of 1981, I began meeting with John Pennell, representing the ABA Tax Section, Richard Cohen, representing the New York State Bar Association, as well as members of the Chief Counsel's Office, notably Paul Francis, to see if we could agree on a general framework for what a workable system of partnership audit might be. We didn't try to draft a statute, both because we understood that that was a congressional prerogative and because we knew that we would need the skills of the drafters in the Office of Tax Legislative Counsel's office—Ward Hussey and John Buckley. What those early consultations developed was a kind of specification document that described the kind of process we wanted to create. Then Ward and John took over and created the partnership audit process and its governing statute, which are largely intact today.

Now, the tax world in 1981 and 1982 was a very different place than it is today. There were no LLCs to speak of, no check-the-box rules, and perhaps most significantly, few large partnerships. The partner "rights" provisions of the 1982 legislation were crafted for a world in which the maximum number of partners in substantially all partnerships would typically number in the dozens or less, not the thousands. The changes that have occurred since then, particularly the growth of large partnerships, have convinced me that a different, more streamlined system for large partnerships is needed and that it is time to reconsider, across the board, the need for many of the partner participation rights provided by the TEFRA procedures.

I suggest that the most productive way to develop such modifications would be to replicate the 1981 consultative exchanges between the Office of Chief Counsel and professionals with broad practical knowledge of how partnership provisions are applied and used today. As we learned in 1981, drafting workable provisions that can be successfully applied to partnerships is not easy, but the result was improved by gaining as much practical input as we could from both inside and outside the Service.

Unfortunately, recent proposals to change the rules have not been developed by such a consultative approach, and they have to date been consistently unsuccessful. That doesn't mean there is not a need for change, but it does

highlight that, in an area as fundamental as this, success is far more likely if the proposal grows out of consensus and consultation.

While there have been a wide variety of proposals for change over the years, I am only addressing a few of them here. One recent proposal has been to decouple liability for audit adjustments from the partners in the year for which the audit adjustment is made and, instead, to impose the liability on either the partnership itself or the current partners at the time of the audit. Whatever gain in collection efficiency might arise from such an approach, it is not an understatement to say that it would be highly disruptive to current business relationships. Consider, as an example, the case of a partnership, a law firm say, that distributes virtually all of its income each year. Such partnerships often change both the membership of the partnership and the relative shares of the partners annually. Imposing the liability of old partners on current ones who received none or a lesser share of the prior year's income is both arbitrary and inequitable. It's hard to see a consensus path for adoption of such a general rule.

That said, there might be lesser steps that could be taken that would allow limited application of such an approach, to explore whether it really would improve the ability to audit partnerships and actually collect on partnership audit adjustments.

The first could be done without legislation and indeed has occasionally been done already. Frequently, audits of large partnerships result in audit results that are significant in dollar terms at the partnership level but relatively modest at the partner level. Some large partnerships have succeeded in negotiating closing agreements with the Service under which the partnership paid an agreed amount for the liability and no change was made to individual partner returns. Because there is no publication or manual provision specifically authorizing such agreements, there are few of them. But this strikes me as a no-brainer: it would be used only when the audited partnership and the Service agreed, so no one would be forced into it. The collection and resource conservation benefits to the Service seem obvious. And it would provide a laboratory for determining how collecting at the partnership level might work in practice.

Another possibility worth exploring is whether liability at the partnership level might be used to inhibit partnership tiering. Tiering of partnerships has long been a problem for the Service. Indeed, providing the Service with a weapon to avoid adverse limitations consequences from tiering was a significant motivation for the original statute. One possibility might be to impose partnership liability (as opposed to partner liability) for additional tiers of multi-tier partnerships. While such an approach would not forbid tiering, it would impose a cost on multiple tiers in the form of different collection mechanics for audit adjustments. Such an approach might prove more politically viable since it would not upset current expectations for single-tier partnerships while providing a limited-scope laboratory for testing whether centralized collection really would be an improvement with a smaller

population that likely consists of more sophisticated taxpayers. This would particularly be true if the current small partnership exception continued to apply without regard to tiering.

We should also consider legislatively overruling the *Rhone-Poulenc* decision.[9] That case held that the Service could adjust partnership items even if the partnership level statute of limitations had expired, so long as the individual partner's statute remained open. This outcome was surprising to me when the case was decided because it is fundamentally inconsistent with the original statutory objective of treating partners consistently. Under *Rhone-Poulenc*, if partner A's individual statute is open, but partners' B, C, and D's individual statutes are closed, and the partnership statute is closed, partner A's share of partnership items can be adjusted, even though no such adjustments can be made to the other partners. Admittedly, like any other rule of limitations, this change would cost the Government money, but if future procedures are to be more partnership focused, this change would reinforce uniform results and eliminate a significant cause of current complexity.

From my standpoint, however, solving the procedural difficulties of partnership audit should not become a subterfuge for undermining the significant ways in which our system had achieved a large measure of de facto integration—that is, single-level taxation of business operations—largely through the widespread use of limited liability companies. As many of you know, I would prefer more systematic integration, as described in the Treasury integration study published on my watch as Assistant Secretary.[10] But I think it would be an extraordinarily poor tax policy to swap the significant informal integration we have achieved to solve procedural partnership audit problems that can be solved in other ways. Double taxation of our most significant form of business organization, the C corporation, is a defect of our system, not a virtue. We need more, not less, integration. Partnership audit procedures need fixing, but double taxing almost all business is not that solution.

I thank all of you for listening patiently tonight, and I thank the College for the opportunity to share these thoughts with you.

[9] Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner, 114 T.C. 533 (2000).

[10] Dep't of the Treasury, Report on Integration of the Individual and Corporate Tax Systems (1992).