

YEAR IN REVIEW

The 2010 Person of the Year

2010 was no ordinary year for taxpayers and practitioners. In fact, it might be called the year of tax administration. Enforcement was the theme of 2009, when the UBS scandal and the campaign against offshore tax evasion dominated the IRS's agenda. Enforcement didn't completely disappear in 2010, but it did cede the limelight to more administrative issues, including the IRS's controversial uncertain tax position (UTP) reporting proposal and its attempt to register and regulate all return preparers. Even the codification of the economic substance doctrine and the IRS's approach to guidance on that topic can be viewed as an administrative issue.

The IRS also restructured the Large and Midsize Business Division, renaming it the Large Business and International Division. That occurred following the passage of the Foreign Account Tax Compliance Act (FATCA), which included new reporting and withholding requirements.

None of those changes were lost on practitioners, and the debate over the UTP program and preparer registration initiative dominated tax conferences and forums throughout the year. The former was heavily criticized all year, while the latter elicited a more measured (and mixed) reaction. At the front lines defending the IRS's UTP program and its policy on guidance was *Tax Notes* 2010 person of the year: Heather Maloy, the commissioner of LB&I.

The Tax Person of the Year

As commissioner of LB&I, Maloy heads an evolving organization that is greatly expanding its interaction with taxpayers.

Maloy held several high-level positions within the IRS before taking the top spot at LB&I in October 2009. Under former IRS Chief Counsel Donald Korb, she served in a variety of roles, including acting deputy chief counsel (technical) and associate chief counsel for income tax and accounting and, later, passthroughs and special industries. Before taking over at LB&I, she spent several years at Skadden, Arps, Slate, Meagher & Flom LLP's Washington office, returning to the IRS after Steven Miller, the LMSB commissioner, was promoted to deputy commissioner for services and enforcement.

Perhaps one of the most memorable events during Maloy's tenure has been the division's renaming and structural change. Although planned division changes were put in motion before she took the helm, she is overseeing the changeover from LMSB to LB&I. The division's realignment was in response to the implicit recognition that international issues could no longer be adequately dealt with if they were scattered across the various operating divisions. "Our economy is global, and a large portion of the issues that are faced by our examiners are, if not all international, a large portion international," Maloy said in a September speech affirming the need for more centralized coordination within the IRS.

The new LB&I seeks to improve international tax compliance and intends to add about 875 new examiners, economists, and technical personnel to the existing staff of 600.

Also new within the past year is the Global High Wealth Industry Group, an addition to the existing industry segments. The group was formed to review the tax compliance of high-wealth individuals — along with the networks of enterprises and entities they control — so that the IRS can better assess the risks those arrangements pose to tax compliance and the integrity of the tax system.

One of the more controversial aspects of heading LB&I that Maloy contended with in the first six months on the job was the rollout of the IRS's UTP reporting regime. Announced by IRS Commissioner Douglas Shulman in January, the program ignited a storm of criticism from the tax bar, industry groups, and large corporate taxpayers. Of primary concern was the degree to which privileged taxpayer information would be revealed, either causing waiver of the information for litigation purposes or creating a roadmap for agents to issue a deficiency notice.

The initial rules for complying with the draft Schedule UTP were modified in their final form to curtail the extent to which taxpayers had to divulge potentially privileged information. Although the changes didn't eliminate all their concerns, taxpayers and practitioners were pleased to see that non-reserved, administrative issues were dropped from the reporting requirements and that the concise description of each UTP no longer was required to include the rationale behind the decision to reserve.



The codification of economic substance in March as part of the controversial healthcare reform package led LB&I to issue one of the only pieces of guidance addressing the issue. The internal memo to the field announced that the accompanying strict liability penalty would be coordinated at the directors' level, but the announcement failed to reduce practitioners' demands for more specific details on how the penalty would be handled and for internal safeguards against aggressive assertion of the doctrine.

Maloy said that as part of the LB&I realignment, the division is rethinking its tiered issue program. Under the program, which is divided into three levels depending on the degree of compliance risk at issue, many of the most scrutinized issues involve international components, such as foreign tax credits, foreign earnings repatriation, and intangibles transfers. Ostensibly, issue tiering allows the IRS to concentrate resources on significant compliance concerns to ensure clear and consistent guidance. However, the program has not been well received by many tax practitioners, who complain that the one-size-fits-all approach removes agent discretion and makes elevation of issues up the chain of command difficult.

Maloy plans to transform the culture of LB&I. Earlier in 2010 she expressed a desire to emulate the private sector's consultative approach and said

LB&I will be working to build internal networks so that agents "feel free to consult, are encouraged to consult, and are rewarded for consulting." Presumably, more interaction among field personnel will keep examiners more apprised of what is going on in general and ensure consistency in positions.

LB&I's efficient use of resources also depends on the successful introduction and use of alternative examination resolution processes. LB&I's compliance assurance process (CAP) program is likely to be made permanent, and new measures to get more corporate taxpayers into the program either through the pre-CAP preparation process or post-CAP maintenance phase will be adopted. Other alternatives like fast-track settlement and mediation are touted as additional ways to resolve taxpayer concerns.

Maloy will continue to face numerous challenges in international tax enforcement, but given the significant changes on major IRS initiatives she's already overseen, it appears she's ready to let 2010 serve as a solid foundation for moving forward.

* * * * *



Hans-Rudolf Merz

Necessity is said to be the mother of invention. The international tax community witnessed an illustration of this in 2010 as Switzerland looked for unconventional ways to preserve its lucrative banking sector. The man at the center of the rescue effort is our international runner up for person of the year: Hans-Rudolf Merz, head of Switzerland's Federal Department of Finance. Merz has changed the way governments around the world think about offshore tax compliance. In case you haven't heard, information exchange is passé; withholding is the new fashion. The paradigm shift may seem subtle, but it could influence how governments tax private wealth for generations to come.

Think back 12 months. The year began amid fears that Switzerland's golden era as a money magnet was ending. "Capital flight" was the buzzword in the press, and all the talk was that investors would soon transfer their fortunes to safer domains. Few events exert so strong a chilling effect as seeing once-secret bank information handed over to the IRS. The heart of the Swiss-U.S. deal, finalized in 2009, is that the IRS may rely on an amended tax treaty mechanism to obtain information about U.S. residents with offshore accounts in Swiss banks. That's no guarantee that Americans with money stashed in Switzerland will be found out; the agreement specifically does not permit "fishing expeditions." Nevertheless, it will have a strong deterrent

effect and creates a substantial enough hole in Swiss bank secrecy to worry investors. (One wonders whether any of the above would have occurred without the admissions of UBS whistleblower Bradley Birkenfeld, last year's person of the year.)

But Americans weren't the only clients of Swiss banks — far from it. Tax collectors from other countries soon approached Bern demanding settlements for their parallel grievances. If other governments insisted on the same information exchange deal the Americans received, it might have been game over for Swiss banks.

Thus, 2010 was a make-or-break year. The duty fell on Merz to find alternate means to satisfy countries' demands that their citizens' offshore income get taxed, while not destroying the competitive advantage of Swiss banks. Such a compromise would require divorcing offshore tax enforcement from financial disclosures. Enter withholding at source.

Source withholding works like this: Swiss banks know where their offshore clients live and how much the clients earn on their deposits. The Swiss government taxes that income and shares the revenue with the appropriate country. The details of the withholding tax, including the rate and revenue-sharing percentages, are to be negotiated separately later. The rate is believed to be around 35 percent — hardly insignificant.

How does a self-imposed withholding tax help the Swiss? The catch is that it's a final withholding tax, conceptually different from standard withholding, which functions as an advance payment of a future tax. Final withholding is entirely different. Once Switzerland withholds the tax, the account holder is permanently relieved of any obligation to declare the offshore income on a tax return. Final withholding *is* the tax, not merely an advance payment, and negates the duty to subsequently declare the income.

Merz's magnum opus was convincing other countries that jettisoning the U.S. approach, with its tedious fixation on information exchange, and agreeing to withholding with revenue sharing was in their best interest. The first countries to buy in were Germany and the United Kingdom, each signing bilateral accords with the Swiss. The French and Italians are reportedly on the verge of executing similar agreements. Country by country, the Swiss hope the rest of the world will follow suit, with only the United States stuck begging for digitized bank data and chasing thousands of tax deadbeats.

Soon, millions of taxpayers from a variety of countries (other than the United States) will be free to stash their wealth in Swiss banks and never mention it to the tax man. Their governments will collect tax dollars — or in this case, Swiss francs —

but they won't know from whom. And they'll never know who because the identity of the offshore account holder purposefully remains secret. By agreeing to Merz's withholding tax, these governments are saying they don't want to know whose income it is. "Who" becomes superfluous. They're content to share in the tax revenue and call it a day.

This trend raises fascinating policy questions. Does it matter if a government doesn't know whose income is being taxed, so long as the tax gets paid by the appropriate party and money ends up in the state coffers? Is it prudent for tax officials to accept "source ignorance" as a tradeoff for the ability to collect boatloads of tax revenue on income that previously went undetected? No tax is being evaded, yet purists surely will be aghast.

We could be witnessing the next mega-trend in fiscal affairs. The tax dodge is gone, and what's left is bank secrecy, transforming Switzerland from a tax haven into a privacy haven, a repositioning that the country's leaders are willing to accept. Welcome to offshore tax compliance in the 21st century.

* * * * *



Paul Ryan

If lawmakers get serious about tackling the country's growing fiscal problems this year, incoming House Budget Committee Chair and taxwriter Paul Ryan, R-Wis., will be at the head of those leading the charge.

Ryan, who was an aide to Sen. Sam Brownback, R-Kan., before running for Congress in 1998, is now entering his seventh term in the House and possibly hitting his stride as his party's top budget expert. In 2006 Ryan defeated the more senior Rep. Ander Crenshaw, R-Fla., for the ranking minority spot on the Budget Committee. Republicans had just lost control of the House, and Ryan argued that the minority party would need a "hunter's vigilant mind-set" — a mind-set that has served Ryan well.

In 2010 he coauthored *Young Guns: A New Generation of Conservative Leaders*, in which he — along with incoming House Republican Whip Eric Cantor of Virginia and Rep. Kevin McCarthy, R-Calif. — outlined his vision for the country's future.

Then there's Ryan's tax reform and entitlement plan, "Roadmap for America's Future 2.0," which has attracted the attention of fellow politicians and political pundits. President Obama called it an "entirely legitimate proposal." The plan, originally offered in 2008, would freeze non-defense discretionary spending, cut Social Security and offer

IRAs, replace Medicare and Medicaid with vouchers and refundable tax credits, rework the individual tax code, and replace the corporate tax with a sliding 8.5 percent subtraction method VAT.

Despite withholding his support for a final report from Obama's National Commission on Fiscal Responsibility and Reform because it did not address the healthcare reform law, Ryan remains a voice for fiscal change. With Republicans steering the House's agenda next year, he'll have a chance to make his plan a focal point of the coming budget debate.

* * * * *



Karen Hawkins

IRS Office of Professional Responsibility (OPR) Director Karen Hawkins kept a busy schedule in 2010 as the IRS continued implementing the new return preparer registration initiative. Somewhat controversial, the expanded preparer oversight program, which Hawkins partially oversees, took on several

thorny initiatives — such as mandatory testing, continuing education, and preparer tax identification numbers — resisted by segments of the return preparer community.

Never hesitant to speak her mind, Hawkins has helped Shulman decide how best to oversee the hundreds of thousands of unenrolled preparers who will now register with the IRS. Responsible for ensuring that practitioners behave ethically in representing clients before the IRS, Hawkins has radically changed the attitude of OPR and worked to develop new ways to soften the office's approach to enforcement while still vigorously pursuing non-compliance. A continuing focus from 2009 was to sharply reduce the backlog of current investigations of, and charges against, practitioners, which went from 75 pending cases down to 35.

A frequent speaker at tax conferences, Hawkins actively engages with the tax community over changes to the Circular 230 rules on practitioner behavior. She has worked to clarify the scope of her office's jurisdiction, noting her oversight of in-house counsel and appraisers, and the broad encompassing of return preparers as individuals who "practice" before the IRS.

Hawkins advocated a change to the Circular 230 section 10.34 proposed rules on ethical standards for tax return preparation, suggesting that the standard, which has fluctuated throughout the years, be changed to reasonable basis. Referring to the previous inconsistency between Circular 230 rules for practitioners and taxpayer standards, "we got it right this time," Hawkins said in September.

In her role as OPR director, Hawkins oversees a staff of about 60, which could expand significantly to handle the increased responsibilities brought on by the influx of additional practitioners under the return preparer regime.

* * * * *



Caroline Ciralo

No stranger to the tax bar, Caroline Ciralo of Rosenberg Martin Greenberg LLP in Baltimore is a legal dynamo. She maintains a diverse tax practice, representing clients in a variety of forums and controversy stages, with everything from innocent spouse cases to employment tax and white-collar defense. She

has been actively involved with the American Bar Association Section of Taxation's Administrative Practice and Civil and Criminal Tax Penalty committees, the latter for which she is a vice chair. Throughout the year, she spoke frequently on voluntary disclosure and foreign bank account report issues and has written several articles on penalties in those areas.

Ciralo was selected by her peers in 2010 as the ABA Section of Taxation Janet R. Spragens Pro Bono Award recipient in recognition of her efforts in forming pro bono tax clinics in Maryland. As a member of the ABA Section of Taxation Fellowship Committee, she helps review applications and select finalists for the fellowship program. She recently finished a term as chair of the Maryland State Bar Association Taxation Law Section.

Super Lawyers included Ciralo among the top 25 women lawyers in Maryland and the top 50 lawyers in Maryland. She serves on the Thomson West Tax Advisory Board and is a member of the Paca Brent Joint Inns of Court. She received her JD from the University of Maryland School of Law and her LLM in taxation from the University of Baltimore School of Law.

* * * * *



Michelle Ferreira

G. Michelle Ferreira, a shareholder with Greenberg Traurig LLP, exerted a lot of influence in 2010 from the West Coast, holding numerous administrative positions within the tax community. The immediate past chair of the State Bar of California's Taxation Section, Ferreira represented the section in

May in its annual foray to Washington for policy paper presentations to Treasury, the IRS, and the Tax Court. She also continued to participate in the state bar's annual tax meeting, moderating several panels and assisting the executive committee. She took on the role of liaison to the IRS Small Business/Self-Employed Division for the ABA tax section's Administrative Practice Committee.

A successful litigator with experience in the IRS Office of Chief Counsel, Ferreira rejoined the newly reconstituted San Francisco office of Greenberg in 2010. Her tax controversy practice involves both federal and state issues, such as estate valuation claims, partnerships, and compliance work, including representation of clients before the California Franchise Tax Board and the State Board of Equalization.

Ferreira is recognized in the 2011 edition of *The Best Lawyers in America* for tax law. She was an adjunct professor for the master's in taxation program at Golden Gate University in San Francisco and is a member of the San Francisco Tax Club. She received her JD from Santa Clara University School of Law.

* * * * *



Kristin Hickman

If a labor of love can be counted by the number of hours spent educating courts in a non-party capacity, then 2010 was a banner year for University of Minnesota Law Prof. Kristin E. Hickman. Hickman's academic specialty — the intersection of administrative law and the tax code — has become an

area of increasing focus for courts. In judicial proceedings at all levels of the federal court system, taxpayers and the government have been arguing over the scope and form of IRS guidance on several important issues.

A prominent question courts grapple with is what level of deference to give the government's administrative rulemaking. Hickman's scholarly writings, which have netted her the distinction as a leading academic in the field, have proved influential as judges sort through decades of conflicting and sometimes misleading case precedent on the issue of statutory interpretation. She participated in several cases in 2010 by filing amicus briefs espousing functional adherence to the requirements of the Administrative Procedure Act in *Neiland Cohen* in the U.S. Court of Appeals for the District of Columbia Circuit, and the proper scope of judicial deference for regulations in *Mayo* before the U.S. Supreme Court.

In 2010 Hickman was appointed the Julius E. Davis chair in law and coauthored a new casebook, *Federal Administrative Law, Cases and Materials*, with Richard J. Pierce Jr.

* * * * *



Lisa Levy

Lisa A. Levy is a partner at Fried, Frank, Harris, Shriver & Jacobson LLP and is an expert on domestic and cross-border tax issues relating to capital markets and financing transactions. She regularly represents U.S. and foreign issuers, borrowers, private equity funds, and investment banks in a variety of transactions, such as equity

and debt offerings, mezzanine and high-yield securities, hybrid securities, and tender offers. She also has significant experience advising on private equity fund formations, securitizations, and mergers and acquisitions.

Levy has served on the executive committee of the New York State Bar Association (NYSBA) Tax Section for seven years. Most recently, Levy was a principal drafter of a NYSBA Tax Section report on the newly enacted Medicare contribution tax on net investment income. In 2009 Levy was involved in responding to Treasury guidance on tax issues arising from the credit crisis. She was the principal drafter of a NYSBA tax report on Rev. Proc. 2008-51 concerning the applicable high yield discount obligation (AHYDO) rules and a letter from the NYSBA Tax Section to Treasury concerning the temporary suspension of the AHYDO rules. At the NYSBA Tax Section's 2009 annual meeting, Levy participated in a panel discussion with Treasury officials on tax issues related to the economic downturn, focusing

NEWS AND ANALYSIS

on application of the original issue discount, cancellation of indebtedness income, and AHYDO rules to distressed borrowers.

Levy received her BS from the McIntire School of Commerce at the University of Virginia, her JD from Columbia Law School, and her LLM in taxation from New York University School of Law. She is consistently recognized by *Chambers USA: America's Leading Lawyers for Business* as a leading individual in tax and by *Legal 500* as a leading tax practitioner on the East Coast.

* * * * *



Stuart Mann

Even before the enactment of the new withholding and information reporting requirements in FATCA, the IRS had already started to increase resources for international withholding compliance, and in November 2008 it appointed Stuart Mann to serve as program manager of the foreign payments group

for LB&I.

In response to the increased globalization of transactions, Mann and his team work to ensure compliance with U.S. withholding requirements for international taxation. In the coming months, Mann — along with LB&I Deputy Commissioner (International) Michael Danilack and Kathy Robbins, the director of LB&I's new International Business Compliance unit — will be leading a team tasked with implementing the FATCA provisions to fight offshore tax evasion with increased information reporting requirements.

For the last several years, Mann has been involved in several high-profile areas, including the IRS tax shelter enforcement and whistleblower programs. Before shifting his focus to international reporting and withholding, Mann was an executive assistant to the LB&I financial services industry director and served as a territory manager and team manager for many large case examinations, including several international withholding examinations. Mann also served on the IRS international money laundering task force in the late 1980s and early 1990s.

Mann has a BA in history from Union College, an MBA in accounting from Pace University, and a JD from Seton Hall University.

* * * * *



Paul McKenney

In 2010 Paul L.B. McKenney worked extensively with the FBAR requirements. Working along the Canada-U.S. border in the Grand Rapids, Mich., office of Varnum, Riddering, Schmidt & Howlett LLP, McKenney has gained a great deal of experience with cross-border tax

issues.

IRS FBAR audits of McKenney's clients generally have not been fruitful. There are many reasons for taxpayers to have overseas accounts, including foreign inheritance, which could come as a surprise to the taxpayer, and vacation homes in other countries, he said.

McKenney also has helped many clients through the IRS voluntary disclosure program, and he said none has buyer's remorse, a result not so much of an awareness of the possible alternative consequences but from what he called "a sense that it's time to move on."

McKenney chairs the ABA tax section's Sales, Exchange, and Basis Committee. At the tax section's September meeting in Toronto, McKenney gave a speech on year-end planning for tax rate increases. Alluding to the last-minute work that legislative changes could require, McKenney said, "I have not made plans to go away between Christmas and New Year's. . . . It might be the mother of all year-end planning."

However, "the next year's going to be fun," McKenney said. In 2011 he expects continued high levels of IRS enforcement activity and increased FBAR audits. He predicted that the Global High Wealth Industry Group within LB&I will take on more cases.

Also in 2011, Schedule UTP filing will begin, amid many open questions. Taxpayers will be making judgment calls on which transactions are large enough to be reported, and despite their best efforts, they may be unable to recognize them all until mid-audit. "I think a fair analogy is to baseball. If someone throws a round ball at a round bat, you have no idea where the ball will go," McKenney said.

McKenney has a BA in economics from Georgetown University, a JD from the University of Michigan School of Law, and an LLM in taxation from

Wayne State University School of Law. He was listed in *The Best Lawyers in America* for 2010. McKenney has served as taxation counsel of the Michigan State Bar Association Taxation Section and chaired the Detroit and Oakland County, Mich., bar associations. He has also been an adjunct professor at Walsh College in Troy, Mich. ■

NEWS ANALYSIS

Humpty Dumpty and the Case for Bank Taxation

By Lee A. Sheppard — lees@tax.org

*Regulating Wall Street:
The Dodd-Frank Act and the
New Architecture of Global Finance*

by Viral Acharya, Thomas Cooley,
Matthew Richardson, and Ingo Walter
(Wiley 2010)

Many people in the City and on Wall Street are the financial equivalent of slumlords or toll collectors in pin-striped suits. If they retired to their beach houses en masse, the rest of the economy would be fine, or perhaps even healthier.

Thus did John Cassidy, citing Lord Adair Turner, Chair of the British Financial Services Authority, shock *New Yorker* readers by explaining that investment banks do not add value to society, as your correspondent has been saying all along (Cassidy, "What Good Is Wall Street?" *The New Yorker*, Nov. 29, 2010).

What do these so-called bankers do? They trade for the banks' own account. Noting that the big banks get most of their revenue from trading, Cassidy explained:

In effect, many of the big banks have turned themselves from businesses whose profits rose and fell with the capital-raising needs of their clients into immense trading houses whose fortunes depend on their ability to exploit day-to-day movements in the markets.

Yet Congress has just passed massive legislation that focuses on banks qua lenders, presumably to borrowers other than hedge funds, from which banks are difficult to distinguish (The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DFA), P.L. 111-203).

What else has happened since this book was published?

1. Spencer Bachus, who is about to become chairman of the House Financial Services Committee, said he thinks Washington and regulators should serve banks, not the other way around.

2. Credit default swap volume has fallen slightly. ICE Trust, the world's largest derivatives clearing