
Tax Litigation Newsletter

Practical Tax Advice From the Field

Published by

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Yes, Taxpayers Can Beat the IRS

We recently won a case that literally “saved the family farm.” A cattle ranching sister and brother had inherited several thousand acres of grazing land. The IRS wanted to increase the value of the estate by \$523,448 due to an alleged undervaluation of the land, and by an additional \$750,000 due to a defective special use valuation election by the attorney who filed the estate tax return. As a result of these adjustments, the IRS claimed an additional \$654,919 in estate taxes (plus interest). The estate could pay these taxes only by selling the farm.

The family retained us to litigate the Tax Court case. In its opinion, the Tax Court rejected 88% of the IRS adjustments. Most significantly, the Court ruled that a special use valuation election may be effective even if the election was defective. This was the first time that the Court had ever made such a ruling.

In another of our recent cases, a closely-held Santa Barbara business worth millions of dollars was reported at a 35% discount on the estate tax return. The IRS claimed that the discount should

be only 27%. In virtually a total victory for the taxpayer on this issue, the Court ruled that the business should receive a 33% discount.

The Tax Court Expedites Its Trials

Until recently, the Tax Court would not hear a case until a year or more after the time that the taxpayer filed the Tax Court petition. The Tax Court has now reduced its backlog of cases, however, and is scheduling trials for 5 to 6 months after the IRS files its answer.

As an example, we presently have a Tax Court case involving \$3,000,000 in gift taxes (plus interest). The Court scheduled the case for trial only 5½ months after the IRS filed the answer.

A Tax Court Trial — Not That Expensive

Civil litigation typically involves detailed discovery that can result in huge legal bills. Litigation in the Tax Court, however, seldom involves any discovery at all. The reason is that the IRS attorney usually relies upon the information gathered at the audit, and the taxpayer seldom has any reason to

gather information from the IRS. Accordingly, the cost of a Tax Court trial is usually much less than the cost of litigation in other forums.

Further, the costs of a tax dispute are deductible on the taxpayers’s income tax return. In an estate tax dispute, the costs may alternatively be deducted on the estate tax return.

In an estate tax dispute, the actual out-of-pocket cost may be only 20% to 30% of the total legal fees. Why? Because the marginal tax rate for estate tax purposes typically is 55% (or even 60%). Every \$100 of legal fees will reduce the estate tax by \$55 to \$60, and in addition will reduce the interest that must be paid on the estate tax. Thus, \$100 of legal fees can reduce the estate’s payments to the IRS by \$70 to \$80 (\$55 to \$60 in taxes, plus \$15 to \$20 in interest).

Qualified Settlement Offers

A provision of the IRS Restructuring and Reform Act of 1998 should increase the chance that the IRS must pay a taxpayer’s attorney fees under Internal Revenue Code section 7430.

Under the Act, a taxpayer may make a “qualified offer” to settle a case. If the offer is rejected by the IRS, and the final Tax Court judgment is more favorable to the taxpayer than the offer, the taxpayer will be the “prevailing party” for purposes of section 7430. Accordingly, if the other requirements of section 7430 are met (e.g., the taxpayer has a net worth less than \$2,000,000), the taxpayer will be entitled to IRS payment of some or all of their attorney fees. The IRS does not like to pay the attorney fees of taxpayers, so the “qualified offer” procedure could pressure Appeals Officers to resolve cases on terms favorable to taxpayers.

Abatement of Interest

Under Code section 6404(g), taxpayers may have to pay only the interest and penalties accruing during the 18 months after the return is filed. Assuming certain conditions are met, this limitation will apply if within that 18-month period the IRS does not provide the taxpayer with a notice stating the taxpayer’s liability and the basis of the liability. This new provision may help to eliminate the delays that now frequently occur in audits. If the IRS, nevertheless, drags out an audit for years, at least the taxpayer’s interest bill will not be increasing the entire time.

Asset Protection Trusts: Are They For You?

Reports of enormous sums awarded to seemingly unworthy plaintiffs have lead wealthy individuals to look for methods to insulate themselves from risk. One method is to use a foreign asset protection trust (APT) in the Cook Islands or elsewhere. Assuming certain requirements are satisfied, an APT is a better method to protect someone from a U.S.-based judgment creditor than almost any other asset protection technique (except certain spendthrift trusts).

Part of our job as estate planners is to assure that most of a client’s assets

are passed to the next generation. Asset protection is part of that process. If you would like to know more about asset protection planning, please drop us a line.

Ambrecht & Associates: Here to Assist You

Ambrecht & Associates is over 20 years old. It is a tax law firm with three lawyers and three paralegals. We limit our practice to tax and trust controversy/litigation; complex estate planning from an intergenerational perspective; family business succession planning (with an emphasis on minimizing family conflict); estate administration; asset protection using foreign trusts and other tools; and certain criminal tax issues. The majority of our clients are in Santa Barbara County, but we also represents clients in other areas of Northern and Southern California. We work closely with our clients’ professional advisors.

Our attorneys are *John Ambrecht*, *Greg Arnold*, and *Lorraine Clark*, each with an LL.M. in tax law. Mr. Ambrecht and Ms. Clark handle our estate planning. Mr. Ambrecht and Mr. Arnold are our tax litigators.

Mr. Ambrecht has practiced law in Santa Barbara since 1974. He is a former chair of the California State Bar’s Estate and Gift Tax Committee, and is the author of numerous tax articles. He has represented over a hundred taxpayers before the IRS, and has been the lead attorney in several Tax Court trials.

Mr. Arnold is a former Attorney/Adviser (law clerk) to a judge on the United States Tax Court in Washington, D.C., a former Senior Trial Attorney with IRS District Counsel, and a former Special Assistant United States Attorney. He is listed as counsel on more than a dozen published Tax Court opinions, and he was the principal government attorney on several related cases

involving a proposed total tax liability of more than a half-billion dollars.

Ms. Clark is a member of the Florida as well as California Bar. In addition to the LL.M., she also has a Master degree in Accounting and is a CPA in Florida. She applies her expertise to all aspects of our tax practice.

In our litigation practice, we represent taxpayers at the audit, at IRS Appeals, in Tax Court, and before the Ninth Circuit Court of Appeals. We also represent taxpayers in criminal cases. The majority of our litigation cases involve estate and gift tax issues, but we will handle any case involving a significant tax liability or a novel issue. The present projects at Ambrecht & Associates include two Tax Court cases involving the value of gifted stock in a closely-held corporation with a present value over \$100 million. We recently completed a case involving the valuation of a shopping center worth over ten million dollars.

This newsletter is intended as a means of communication between Ambrecht & Associates and the professional community regarding current tax litigation issues. We are pleased to answer questions about the tax litigation process. Just call or e-mail Greg Arnold at 805/965-1329 or arnold@taxlawsb.com. If you would like to remain on our mailing list, drop us a note, give us a call, or send an e-mail to queries@taxlawsb.com.

We Have Moved!

To better serve our clients, we have moved to Montecito. Our new location is 1224 Coast Village Circle. We are in Suite 32 on the top floor. There is ample free parking by the building. Our phone and fax numbers are unchanged.