taxanalysts
The experts' experts.
Tax Notes Today

JULY 18, 2011

Tax Analysts Exclusive: Conversations: Prof. Charlotte Crane

by Shamik Trivedi

Summary by taxanalysts

Tax Analysts' Shamik Trivedi recently spoke to Charlotte Crane, a law professor at Northwestern University School of Law and the IRS professor in residence for the 2010-2011 academic year, about the IRS guidance process, the effect of the Supreme Court's decision in Mayo, and the chances for corporate tax reform.

Charlotte Crane

Charlotte Crane is a law professor at Northwestern University School of Law, where she teaches corporate tax and tax policy in both the JD and graduate tax programs and frequently conducts an annual colloquium for academic tax scholarship. She began her law career in 1976 as a law clerk for Judge Wade H. McCree of the U.S. Court of Appeals for the Sixth Circuit and later served as a law clerk to U.S. Supreme Court Justice Harry A. Blackmun. She also worked as an associate at Hopkins & Sutter in Chicago.

Crane served as the professor in residence at the IRS Office of Chief Counsel for the 2010-2011 academic year. She recently spoke with Tax Analysts' Shamik Trivedi about the IRS guidance process, the effect of the Supreme Court's decision in *Mayo*, and the chances for corporate tax reform.

Tax Analysts: How does the guidance process work?

Charlotte Crane: From what I was able to see, much depends on the kind of project. Some projects are driven by new legislation, when everyone sits down at all levels and figures out what needs to be done and how the work should be divided up. Other guidance is triggered when a particular issue gets raised in dealings with taxpayers -- whether through the formal ruling process, requests from professional associations, or questions that come from the field. Different questions end up being handled differently, with different levels of review for each kind of guidance.

After the particular topics are raised, what happens depends upon what kind of guidance seems most appropriate -- whether it's going to be chief counsel advice or general legal memorandum or regulations or just a notice. Sometimes it's clear from the beginning what form the guidance will take, and sometimes it takes time working through the issues before it's decided what type of guidance will be issued.

TA: On what sort of guidance projects did you participate?

Crane: There was a project that might have been a private letter ruling that turned into a notice. There was another project that might have resulted in regulations, but if it is ever issued, will be done as Q&As. How those will be released is still up in the air. Both of those, however, were not usual projects.

TA: When you were participating on those projects, did the IRS look to you for academic input?

Crane: It varied all over the map. My role on some projects was essentially the same thing that any experienced reviewer would be doing. On other projects, they needed someone who knew what I serendipitously happened to

know about, because I was a law professor who had looked at more than just the federal income tax and knew how other tax systems worked.

TA: Did you find that the Service would call you for specific types of guidance projects, or were you involved generally as a member of the staff?

Crane: There were three primary routes through which I became involved in those projects. The most flattering one was when someone knew that I might know something about a particular issue, and they would ask me to be involved.

Another route was for certain projects that for whatever reason needed a level of review, and it made just as much sense to have me do it than someone else in the front office. Some of those were fun because they were regulation projects waiting to be approved by chief counsel and the commissioner. Some of them made it out of Treasury when I was there; others are still waiting. Learning about preambles and *Federal Register* rules and what all those asterisks mean -- that was a world that I had never really been a part of.

The third way in which I was involved in the guidance process was my attendance at meetings where an associate chief counsel would present their pending projects. Sometimes I knew enough about a subject in which they did not have an answer to help formulate an answer. To be welcomed into that process, under those circumstances, and to be able to help with an answer was gratifying.

It's a tricky business. There are a lot of people who have a lot invested in their subject matter. Strangers to the process can be viewed with a lot of "Why does she think she knows anything more than we do?"

TA: Did previous professors in residence or other types of visitors to the chief counsel's office warn you about that?

Crane: Not really, but everyone's personality is different, so the way they're going to insinuate themselves into the process as they start at chief counsel's office and how they create their role will be different for everybody.

TA: What do you think are the impediments to putting out guidance? Do they arise out of the interaction between chief counsel and Treasury?

Crane: First, putting out guidance is by no means the only thing chief counsel's office does. Guiding the litigation process is a huge part of what goes on. It was interesting for me to realize how much I enjoyed some of the litigation strategy discussions. Most, but not all, was at the appellate level -- which cases we should be asking the Department of Justice to appeal and which arguments to emphasize or let go.

So it would be wrong to assume that because there is no formal guidance, there aren't positions being developed. Sometimes those positions are evolving as the litigation proceeds. It's better if you can provide guidance. Guidance is as much for the IRS as it is for the practitioners, and that's something that I really appreciate having been reminded of. There's a lot of litigation that goes hand in hand with good guidance. The better the guidance, the easier it is to get the cases you need to get to stay in touch with compliance problems.

As for impediments to guidance, I suppose one of the biggest is legislation that, for better or worse, is not self-executing. Sometimes Congress knew that it didn't know enough about the details of how a rule should be implemented, and it properly gave the details to the IRS to work out. Other times, Congress just doesn't want to make the political call -- even the "small p" political call. Knowing that it was too hot for Congress to handle makes it difficult for Treasury and chief counsel to act decisively. When people sense that Treasury may be reluctant to take a stand, that reluctance, that foot-dragging, can show up at lower levels as well.

Staff attorneys will work on things not knowing whether the tentative policy calls they've been given are going to stick. It's very hard to tell from the vantage point of a drafting attorney in chief counsel's office whether something they've been told to work up is the policy somebody has actually decided or whether it's simply a position they've been told to work on just to see what it would look like.

TA: Do you think that could be fixed through better direction from higher levels at chief counsel, or do you think the

general problem lies with Congress?

Crane: There's no single identifiable problem. The not-well-thought-through legislation, I think, is a bigger problem now than it has been in the past, for a lot of different reasons. That just amplifies whatever dysfunction there might be between Treasury and regulation drafters.

TA: What sort of problems exist with Congress's mandates to the IRS?

Crane: People don't realize, but the IRS has many different kinds of relatively new challenges. Not only has Congress expressly given the IRS a lot more different kinds of things to do recently given the increasing number of programs administered through tax expenditures, but there are a lot of the other initiatives the federal government has undertaken that raise difficult tax issues -- for instance, the steps taken in response to 9/11 and in response to Hurricane Katrina. These initiatives have presented new problems in developing appropriate doctrines and positions with respect to the potential taxpayers who are participants in those programs.

A lot of forms of emergency relief have created problems in determining the tax base. It used to be that the general welfare doctrine easily covered most of the types of public aid that was given, so recipients did not need to worry about taxable income and payers did not have to worry about income reporting. Most aid went to taxpayers who weren't on the tax rolls or were barely on the tax rolls at all.

There's much more aid given in the form of dollars rather than in kind and much more aid available to taxpayers who you cannot easily presume are not on the tax rolls. In trying to sort through the appropriate approaches, Congress has in some cases indicated what the answers ought to be, but not in every case.

TA: Would you lump earned income tax credit recipients into this, or leave the issue simply to those taxpayers who are receiving aid because of some catastrophe?

Crane: No, the problems I am referring to are not closely related to the administration of the EITC. Anytime you give someone a dollar, where they spend it is going to be relevant for tax purposes. You have created questions about how to treat that dollar for tax purposes, even if you have clearly said that the receipt of that dollar shouldn't be treated as taxable income. Congress has responded in some cases, but not in all. There are many, many places where people can benefit from state tax credits, from forgivable loans, or receive some other form of state assistance and discover that the interaction of these items with the federal tax system is not clear.

One of the huge areas where practitioners are well aware of this problem is the lack of an equivalent of section 118 for non-subchapter C entities. What happens when passthrough entities receive government aid? For subchapter C entities, it's clear -- you can take the aid, it is not income, but you don't get basis. For passthroughs, we're having a much harder time figuring it out. Sometimes the recipient should be treated as receiving income and be allowed offsets thereto under the ordinary rules for accounting for costs. Other times the recipients may properly be only the agents of others when they handle funds. The problem isn't limited to passthroughs that are involved in business; there are lots of places where these questions are coming up for individuals.

TA: Is there a greater emphasis on drafting more distinguishing regulations or regulations that are clearer following the Supreme Court's decision in *Mayo*? Is the chief counsel's office being more careful in its method of drafting regulations? (For *Mayo Foundation for Medical Education and Research v. United States*, No. 09-837 (U.S. Sup. Ct. Jan. 11, 2011), see *Doc 2011-609* or *2011 TNT 8-10* .)

Crane: Remember that nothing turns on a dime. I hope it doesn't look like the chief counsel's office and Treasury guidance have come to a full stop, because that's definitely not the case. I think that the biggest difference that *Mayo* should make is a willingness on the part of the regulation writers and the policymakers to draw lines that you might not arrive at through the common law reasoning process. Tax administration sorely needs bright lines that are salient and enforceable, but these are often not the same kind of rule that you would end up arguing to a court should be the most obvious interpretation of the statute.

Consider the 40-hour limit, which was the crux of what was different about the regulation in *Mayo*. You can't go from the use of the word "employee" in the statute to drawing the bright-line 40 hours through any kind of deductive reasoning. You could say it's a common standard and that Congress seems comfortable with it, but you can't get

there by saying, "Employee means this." I think implementation of the tax law will benefit a lot from regulations that reflect a greater willingness to make those kinds of calls, that kind of line drawing.

How soon -- if *Mayo* sticks -- you'll see more of that kind of rule is hard to tell. Some rules like this exist in regulations already, but they need to be used more often. More regulations should be written using such bright lines even in places where you could have had a common law rule, because the common law rule is usually harder to enforce than the bright-line rule.

TA: You teach basic and advanced corporate tax as well as tax policy at Northwestern University School of Law. What's your prediction on whether corporate tax reform will happen before the 2012 election?

Crane: I'm mildly pessimistic. Perhaps the source of my pessimism is reflected in the fact that corporate tax reform seems to have two or maybe even three different meanings. One seems to be all about trying to make better sense out of the taxation of multinationals. The other seems to be trying to make sense out of the corporate tax base. Closely related to that, but different in at least some of the ways it is articulated, is trying to make sense out of what entities are taxed and how.

Those are three very different projects. You could tackle all of them at the same time, particularly the second and the third, but given how rare it is to tell which project people are talking about when they discuss corporate tax reform suggests that there is a lot of distance between whatever calls there are for reform and actually making sense out of what it looks like.

TA: Is corporate tax reform inseparable from individual tax reform?

Crane: We've never made much sense about why there's a separate corporate tax. The best explanation, historically, has been as a collection device that is a backstop to the individual income tax. That isn't a good justification for it anymore, partly because of the way rates now work and partly because too much capital is no longer in the traditional subchapter C form. If what you want to do is fix the corporate tax as it has been traditionally envisioned, you end up with very different answers than if you want to make sense out of taxing business capital across the board. Those are two very different projects. I think Congress will probably make some progress in the first, but the second is where the real payoff will be, if Congress can bring itself to do it.

TA: Right now, we're without a Treasury assistant secretary for tax policy. Do you think that is a barrier to comprehensive reform, especially given Treasury's role in the 1986 reform effort, with Treasury I and II acting as a catalyst for congressional action?

Crane: Does effective tax reform have to come from Treasury? I think the answer is probably not, but I don't know where it is likely to come from. I suppose another way of thinking of the situation is, if the vacancy remains, what does it mean about leadership in that set of issues? The politics that lead to the vacancy in that spot are the same politics that make tax reform difficult.

TA: Chief Counsel William J. Wilkins was apparently offered the position of assistant secretary for tax policy and turned it down. He was intimately involved in the Tax Reform Act of 1986 as staff director for Senate Finance Committee Democrats. Do you think he'll have any impact in shaping tax policy outside of chief counsel's office?

Crane: From what I've seen, he takes his job as the commissioner's lawyer very seriously. Therefore, I think he'll be very strong on advocating for the kind of policy implementation that is appropriate for the commissioner to be doing, like Schedule UTP. I have every reason to believe that he will be very good at picking the issues that are worth bringing up from the Service's point of view and making sure they are aired at Treasury and on the Hill. It's not clear the public will see all of that, because agenda-setting decisions are not always obvious in the things that are immediately made public as they happen.

TA: What's your take on the IRS's ability to implement facets of healthcare reform?

Crane: The IRS and chief counsel will always have difficulty doing things that there's a strong political will they not do. I happen to believe that the people charged with healthcare -- and the tax part of healthcare is actually a very small part of it -- are determined. I was pleased to see the way they are approaching their jobs. They have found

and will continue to find sensible solutions to most of the problems they face.

TA: Will funding be an issue for implementation?

Crane: There are two levels of implementation. There's figuring out what the implementation system looks like. That's what chief counsel and its equivalents at other agencies are doing now. Then there is the on-the-ground, day-to-day implementation. I would worry about the resource questions with regard to the latter more than the former. You always want to be supported better, but it is amazing what you can do when you want to do it, even with little resources.

TA: In the last few years, we've seen a greater emphasis on information reporting as a way to close the tax gap. Do you suspect this will be a permanent feature of income tax collection, or is it something more temporary, as a way to increase revenues without raising taxes?

Crane: That's an interesting question because there was more information reporting in the original income tax after the ratification of the 16th Amendment in 1913 than there has been since, strangely enough. For example, most financial payments other than simple bank interest originally required information reporting. That was never successfully implemented, and the attempts were abandoned. That's actually something I'm researching now.

Similarly, the Civil War taxes required much more information reporting. One of the reasons for that was because the British, who first imposed their income tax at the turn of the 19th century, not only had more information reporting but also more withholding at the source. So if you're a tenant farmer and you owed £100 in rent, you paid £2 to the revenue and £98 to your landlord. That was how income tax was collected from your landlord.

I think we have a long way to go before we're willing to do that across the board with all types of financial payments. The episode with the various forms of information reporting in the last year or two suggests there is no political stomach for that. Yet I think there will be more because it's possible. In much of tax administration, the answer lies in not what sounds good but what can actually be done. To the extent that more can be done, more will be done.

TA: Do you look at offshore account reporting and programs like the Foreign Account Tax Compliance Act or foreign bank account reporting as a new paradigm in tax collection? In the past, it was almost colloquially or even perhaps universally understood that offshore accounts would be safe from IRS scrutiny.

Crane: There is certainly a lot that Congress has asked the IRS to try to do that is very new. Some of it less astonishing than other parts of it, but I think that in reality, whether it works in a way that makes it worthwhile will depend upon what the rest of the world's response actually is.

It was interesting -- I went to a D.C. Bar-sponsored session on customs and trade regulation. It occurred to me as I was listening that in that area, the trade position of the U.S. really was strong enough that in its post-9/11 trade rules for implementing security, it was able to bring the rest of the world around to doing things the way the U.S. thought it needed to be done. Now this was a negotiated process, but we took the lead, and most of the rest of the world wanted to be able to sell to us, so they followed and adopted for themselves approaches quite close to what we wanted to put into place.

The foreign account reporting and withholding regime might have a chance of working if our initiatives turn out to be part of what the rest of the world is trying to do. Our position with respect to financial markets and world capital movements may unfortunately be different than was our influence over world trade practices, when we were everybody's best customer. So maybe we'll get somewhere, and maybe we won't.

TA: Do you see yourself ever returning to the government in a different capacity?

Crane: It's certainly something I'd be willing to do if it was for a job that I thought people really wanted done and that I thought I had the right skill set for. Sure. Taking a job for some of the reasons that somebody younger and anxious to build a career might take? I'm a little old for that. One of the things I really enjoyed as professor in residence was the feeling that I could help people get a better work product out and give them some assurance about what they were doing. I liked being able to do that. Any job that would let me do that would be appealing to

me.

TA: You've been a Supreme Court clerk, law firm associate, professor of law at Northwestern, and the IRS's professor in residence. Which did you find to be the most rewarding?

Crane: I'm not sure that's a fair question because the rewards expected at different phases in anyone's life are so different, not having anything to do with what the job is, but what the next job might be or why the experience might be worthwhile in the long run. There are a lot things people might be willing to do because they might be worthwhile not in the short run but in the long run, but for the experience and the credential.

There are certainly aspects of being a regular old law professor that are very rewarding. There are times when you wonder how many tax lawyers the world needs, and so there are times when teaching people who think they want to be tax lawyers is a mixed bag. But helping people understand how the tax law more generally needs to work and helping people understand what kinds of implementation make it a better system and what kinds of implementation aren't going to help make a better system -- that can be very rewarding. I'm glad to have been able to go to the IRS and have reinforced some of my thoughts about that and some new thoughts, too.

It is not the case that the most intellectually appealing rule or approach is going to be the best implementation. I'm afraid that one of the things that may have happened to the income tax is that people have lost sight of this fact.

TA: Having worked at the IRS as a professor in residence and now returning to academia, what do you think needs to change in the legal studies curricula, knowing how things work in the government or in private practice?

Crane: I'm not sure that a curricular change in the sense of different courses or teaching methods is really necessary, but some changes should be made in what happens within those courses. I think there's an awful lot of what gets taught at law schools that is based on what you learn from appellate cases. For tax law, it is not clear that that works. Take, for example, *Commissioner v. Duberstein* [363 U.S. 278 (1960)], a case that most professors spend a lot of time talking about. It's a horrible, horrible decision. It's a decision that says that a very common question can only be answered by looking at the facts -- facts that are very hard to determine, requiring subjective intent. Surely there are better ways to spend our tax administration resources than inquiries into that kind of subjective intent.

Happily, Congress responded to the need for a clearer rule, and now there is a clearer rule in the statute for some, but not all, of what *Duberstein* tried to cover. I think that more appreciation of that kind of a bright-line rule, rather than subjective, factually dependent rules is important.

I think if all the courses were taught with a better appreciation for the fact that no matter how you define a tax base, unless that definition has some meaning in the real world, and unless you can actually collect against the things that that tax base represents, you're kidding yourself if you think your tax base definition describes your tax system, because it doesn't. I think that most courses should include -- at least if they're going to talk about tax policy at all -- a healthy dose of that reality. Defining the tax base is only the first step in collecting the taxes the people thought they were going to collect.

TA: What scholarship are you working on now?

Crane: I'm working on a continuation of work that I've been doing for a number of years now on the history of tax administration. There's a lot of tax history these days that is about the choice of tax base and the politics associated with that. I'm trying to follow up on what happens after the major political decisions have been made. What works administratively can make an enormous difference in how the tax is actually felt. But determining how a tax was actually administered can be an overwhelming task. There's no way that anybody can actually show what the disparity between the tax base as defined and the taxes as collected ever was at any given point in time. Nevertheless, I am hoping to figure out a little better how the administrative systems worked, how the courts interacted with the administrative process -- not just in judicial review of regulatory positions, but in allowing or not allowing various kinds of litigation activity. For instance, over time and in different jurisdictions, there has been considerable variation how much courts -- rather than the legislature or the administrators -- have been involved in the evolution of the tax base. Similarly, there has been variation in the extent to which courts have been willing to

participate in tax administration -- whether on behalf of the tax collector or the taxpayer -- in the absence of expressed legislation conferring jurisdiction.

One of the reasons I wanted to do the professor-in-residence job was because I actually know more about the administration of federal tax laws in earlier times than I did about the contemporary situation. Although nine months is nowhere near long enough to really understand the contemporary situation, I feel like I have a better handle on it than when I went in.

Tax Analysts Information

Jurisdiction: United States
Subject Areas: Tax system administration issues
Tax reform
Corporate taxation
Subchapter S corporations
Individual income taxation
Information reporting
Tax history
Magazine Citation: Tax Notes, July 18, 2011, p. 241; 132 Tax Notes 241 (July 18, 2011)
Author: Trivedi, Shamik
Institutional Author: Tax Analysts
Tax Analysts Document Number: Doc 2011-15274
Tax Analysts Electronic Citation: 2011 TNT 137-4
