

those who believe that recent comments by high-level government official on tax shelters lack a certain appreciation for the shade-of-gray judgment calls that are a regular part of international tax planning.

The *Pasquantino* decision also raises more general tax policy concerns. On one hand, it is obviously desirable that revenue laws be rigorously enforced. Increased international cooperation in enforcement furthers that objective and is a laudable goal. On the other hand, foreign revenue laws may be confiscatory, lack due process, or have other flaws, and it is arguably not appropriate for one sovereign to enforce the laws under those circumstances or to have to make judgments about these matters with respect to another sovereign's laws, or question the policies behind another sovereign's revenue laws. Although *Pasquantino* seems to strengthen the ability of governments to collect taxes in other countries, it may undermine the vitality of the tax treaty provisions that govern most international tax collection coordination efforts. Such provisions are predicated on the inability of governments to enforce their tax laws abroad in the absence of such agreements. If this predicate is eroded, treaty negotiators could find it more difficult to obtain the consent of their treaty partners to these reciprocal tax collection pacts. Enforcement that can now occur with certainty under the provisions of tax treaties would be left to the vagaries of case-by-case determination in each country.

These issues are important to taxpayers, in-house tax professionals, and advisors. They create significant uncertainty in areas previously thought settled. And they add additional complexity to an area already beset by the unanswered questions posed by Circular 230, conflicting court cases and administrative guidance on the appropriate standards to be applied to tax planning, as well as changing domestic and foreign rules regarding tax planning disclosure and penalties and, of course, last but certainly not least, Sarbanes-Oxley. How this uncertainty will ultimately affect taxpayers

and tax professionals is currently unclear, but perhaps the Second Circuit will bring some needed elaboration to this corner of the tax world with a well-reasoned opinion in *RJR Nabisco*.

## THE NEW PAYMENT VS. DEPOSIT LANDSCAPE

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U ntil October 2004, a Revenue Procedure provided for two types of remittances to the Internal Revenue Service (IRS): payments and deposits. *See* Rev. Proc. 84-58, 1984-2 C.B. 501. While each stopped the running of underpayment interest, *id.* at § 5.01, they differed in two important ways. First, a deposit generally was returnable upon request until such time as the IRS assessed tax, *see id.* at § 4.02(1), but for return of a payment, the taxpayer had to follow the refund claim procedures, *see, e.g.*, Treas. Reg. § 301.6402-2(a)(1). Second, a payment but not a deposit could give rise to overpayment interest. Rev. Proc. 84-58, *supra*, at §§ 5.04, 5.05.

October 2004 saw the enactment of new statutory authority for deposits. *See* I.R.C. § 6603(a). Section 6603 provides that such deposits (1) if used to pay tax, are treated for underpayment interest purposes as paid when made, I.R.C. § 6603(b); (2) are returnable upon request to the extent not used to pay a tax, unless collection of the tax is in jeopardy, I.R.C. § 6603(c); and (3) in the case of multiple deposits by the taxpayer, are “treated as used for the payment of tax in the order deposited,” I.R.C. § 6603(e)(1), and are “treated as returned to the taxpayer on a last-in, first-out basis,” I.R.C. § 6603(e)(2).

Perhaps most important for many taxpayers, section 6603(d) allows taxpayers to earn interest, at the Federal short-term rate, on a returned deposit that was “attributable to a disputable tax.” This provision allows a taxpayer who has a controversy with the IRS to remit an amount prior to receiving a notice of deficiency that, as a deposit,

will not preclude the taxpayer from going to Tax Court, and yet, unlike under prior law, will earn interest (though not at a rate as high as overpayment interest, *compare* I.R.C. § 6621(a)(1) with I.R.C. § 6621(b)). The “disputable tax” requirement should prevent taxpayers without a tax controversy from using the IRS essentially as an interest-bearing bank account.

Section 6603(a) provides that “a deposit shall be made in such manner as the Secretary shall prescribe.” Revenue Procedure 2005-18, 2005-13 I.R.B. 798, published in March 2005, provides helpful guidance for taxpayers seeking to earn interest on deposits. It also provides a process for redesignating an outstanding deposit as a deposit eligible for interest under section 6603(d). *Id.* § 5.

In addition to providing procedures under new section 6603, the new Revenue Procedure also supersedes Revenue Procedure 84-58, which “provide[d] procedures for taxpayers to make remittances in order to stop the running of interest on deficiencies,” Rev. Proc. 84-58, *supra*, at § 1, and provided information about how the IRS would characterize undesignated remittances, *see id.* at § 4. Revenue Procedure 2005-18 thus tackles two distinct tasks. Unfortunately, neither the applicability of the Revenue Procedure to certain remittances nor its characterization of some remittances is entirely clear.

Revenue Procedure 2005-18, unlike superseded Revenue Procedure 84-58, contains a “scope” section, which states that it “applies to remittances made to stop the running of interest on deficiencies, including remittances treated as deposits under section 6603.” Rev. Proc. 2005-18, *supra*, at § 3. The wording of the scope statement suggests that the taxpayer's intent in making a remittance may affect whether or not the Revenue Procedure applies to it. However, if, for example, the taxpayer makes a random remittance for a particular tax year in the mistaken belief that taxes are due, with the sole thought of complying with this perceived tax obligation, the taxpayer's

lack of focus on interest should not remove the remittance from the scope of the Revenue Procedure.

Even where the Revenue Procedure clearly applies, unanswered questions about its characterization of certain remittances remain. For example, imagine a check, remitted to the IRS containing the notation “deposit” and a tax year (or accompanied by a statement containing that information) but unaccompanied by other information, that is remitted to the IRS to stop the running of interest. Under the Revenue Procedure, to “make a deposit under section 6603,” the taxpayer must remit a check or money order that must, among other things, be “accompanied by a written statement designating the remittance as a deposit.” *Id.* at § 4.01(1). The Revenue Procedure further provides that the written statement must contain certain additional information, including “the amount of and basis for the disputable tax.” *Id.* Thus, on the surface, at least, it appears that the hypothetical remittance is not a “deposit under section 6603” under the Revenue Procedure because it lacks the required additional information. In effect, the Revenue Procedure seems to term “deposit[s] under section 6603” only those deposits that meet the requirements for earning interest under section 6603(d). The statute is structured differently, apparently treating interest-earning deposits as a subset of section 6603 deposits.

The heading of section 4 of Revenue Procedure 2005-18 is “PROCEDURES FOR MAKING DEPOSITS UNDER SECTION 6603; TREATMENT OF OTHER REMITTANCES,” implying that section 4 discusses how the IRS will treat remittances that do not constitute deposits under section 6603 within the meaning of the Revenue Procedure. However, section 4 only characterizes those other remittances that are “undesignated remittances” and the Revenue Procedure apparently uses that term as a term of art; it discusses the IRS’s characterization of “a remittance that is *not designated as*

*a deposit* (an ‘undesignated remittance’) . . .” *Id.* at § 4.01(2) (emphasis added). It is hard to imagine that a remittance labeled “deposit” by the taxpayer would constitute “a remittance that is not designated as a deposit,” particularly because the Revenue Procedure treats many undesignated remittances as payments. *See id.* Thus, the hypothetical (partially designated) remittance may not be characterized under section 4.

Section 4.02 of Revenue Procedure 2005-18 does address how a deposit is treated once an IRS audit is complete. However, that section does not seem to characterize a remittance as a deposit in the first instance. The Revenue Procedure refers to taxpayer-designated deposits later in section 4, stating that “[a] remittance that is made before the decision of the Tax Court is final and specifically designated by the taxpayer in writing as a deposit, is not a substitute for a bond to stay assessment and collection described in section 7485.” *Id.* at § 4.05(2). Similar language appeared in Revenue Procedure 84-58 but it followed the following statement: “A remittance made after the mailing of a notice of deficiency but before the expiration of the 90-day or 150-day period, or, if a petition is filed, before the decision of the Tax Court is final, and [that] is specifically *designated by the taxpayer in writing as a ‘deposit in the nature of a cash bond’*, will be treated as such by the Service.” Rev. Proc. 84-58, *supra*, at § 4.01(2) (emphasis added). Revenue Procedure 84-58 also provided that “[a] remittance made before the mailing of a notice of deficiency that is designated by the taxpayer in writing as a deposit in the nature of a cash bond will be treated as such by the Service.” *Id.* at § 4.02(1).

Thus, although ordinarily one would expect the IRS to treat a remittance labeled “deposit” as a deposit (consistent with the taxpayer’s apparent intent), the difference between the language used in the two Revenue Procedures raises the obvious question of why the recent Revenue Procedure does not carry over the prior Revenue Procedure’s explicit

statements in that regard. It may be the intent of Revenue Procedure 2005-18 to treat as a (non-interest-earning) deposit under section 6603 a remittance designated as a deposit by the taxpayer but not meeting the requirements to earn interest under section 6603(d). However, that is not how the Revenue Procedure reads.

In sum, section 6603 and the Revenue Procedure provide the informed taxpayer involved in a tax controversy an opportunity to post a deposit that not only will limit liability for underpayment interest but can itself earn interest. Unfortunately, although the new Revenue Procedure supersedes Revenue Procedure 84-58, it leaves unanswered a number of questions with respect to the characterization of certain remittances. This could give rise to conflicts between the IRS and taxpayers who are unaware of the new procedures or do not follow them precisely.

## RECENT RULING EXPANDS SCOPE OF LIKE-KIND EXCHANGES

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In Revenue Ruling 2004-86, the IRS distinguished two prior rulings and thus expanded the types of interests that will produce nonrecognition treatment when exchanged in a section 1031 transaction. Rev. Rul. 2004-86 treats ownership of interests represented by certificates of trust in a Delaware Statutory Trust (DST) owning real estate as actual ownership by the taxpayer of the real estate. The ruling is premised on the fact that under Subchapter J of the Code (sections 671 *et seq.*) *i.e.*, the grantor trust provisions, each certificate holder is treated as the owner of an undivided fractional interest (UFI) in the DST, and is considered to own the trust assets attributable to the UFI of the DST for federal income tax purposes. Accordingly, § 1031(a)(2)(E), which excludes “Certificates of Trust” from exchange treatment, is inapplicable.