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# Federal Taxation

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## I. INTRODUCTION

In 2004 the Eleventh Circuit Court of Appeals published three tax decisions of note. In the first of those decisions, the Eleventh Circuit held that taxes that are untimely assessed, yet properly owed and duly paid, are not refundable.[1] In the second, a criminal tax evasion case, the Eleventh Circuit held that enhancing a criminal sentence due to obstruction of justice for making false statements to conceal a fraudulent tax return was not "double counting" under federal sentencing guidelines.[2] Finally, in a brief opinion, the Eleventh Circuit held that "toters" used to transport manufactured homes did not qualify as "tractors" under the definition of section 4051(a)(1)(E) of the Internal Revenue Code of 1986, as amended (the "Code"),[3] and therefore, were not subject to a twelve percent federal excise tax.[4]

The United States district courts within the Eleventh Circuit also published three noteworthy tax decisions. In one of those decisions, the United States District Court for the Southern District of Florida applied

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This Article does not represent the views of King & Spalding LLP, but solely reflects the views of its Authors.

1. Williams-Russell & Johnson, Inc. v. United States, 371 F.3d 1350, 1352-53 (11th Cir. 2004).
2. United States v. Uscinski, 369 F.3d 1243, 1247 (11th Cir. 2004).
3. I.R.C. § 4051(a)(1)(E) (2000). Unless otherwise noted, all section references are to the Code.
4. Horton Homes, Inc. v. United States, 357 F.3d 1209, 1212 (11th Cir. 2004).

policy considerations in disregarding the literal language of section 4251.[5] The court held that the excise tax provided for in that section applied to long-distance telephone services that were billed according to toll charges that varied by time alone, and not by distance.[6] In another case, the United States District Court for the Middle District of Florida held that an employee leasing company was a co-employer for purposes of employment withholding taxes, and therefore was liable for the payment of those taxes.[7] Finally, in a third decision, the United States District Court for the Middle District of Georgia concluded that the Internal Revenue Service must consider an offer in compromise from a debtor in bankruptcy proceedings on the same grounds as it would consider a similar offer from any other taxpayer.[8]

## II. ELEVENTH CIRCUIT CASES

### A. *Untimely Assessed But Properly Owed and Duly Paid Taxes Not Refundable*

In *Williams-Russell & Johnson, Inc. v. United States*,[9] the Eleventh Circuit affirmed a decision of the District Court for the Northern District of Georgia that employment taxes that were untimely assessed, but otherwise properly owed and timely paid within the statutory period for assessment and collection, were not overpayments and should not be refunded.[10]

Between 1993 and 1995, Williams-Russell & Johnson, Inc. ("WRJ") filed its monthly employment tax returns and duly paid its employment taxes as it estimated them. The Internal Revenue Service (the "Service") determined that WRJ owed additional employment taxes during this period but failed to assess the deficiency until June 1999, after the applicable three-year period of limitations under section 6501(a)[11] had expired. The Service conceded that it could not collect the unpaid balance it assessed in 1999 because of the statute of limitations. The taxpayer, however, subsequently filed a claim for refund, arguing that the late assessment entitled it to a refund of all employment taxes it paid between 1993 and 1995. The Service denied the claim for refund

5. Am. Bankers Ins. Group, Inc. v. United States, 308 F. Supp. 2d 1360, 1367-88 (S.D. Fla. 2004); I.R.C. § 4251 (2000).
6. *Am. Bankers*, 308 F. Supp. 2d at 1367-68.
7. United States v. Total Employment Co., 305 B.R. 333, 341 (M.D. Fla. 2004).
8. IRS v. Holmes, 309 B.R. 824 (M.D. Ga. 2004).
9. 371 F.3d 1350 (11th Cir. 2004).
10. *Id.* at 1352-53.
11. I.R.C. § 6501(a) (2000).

on the basis that it was barred by the statute of limitations under section 6511.[12]

The United States District Court for the Northern District of Georgia dismissed the taxpayer's case for lack of subject matter jurisdiction, finding that there was no overpayment and that, in any event, the claim was time-barred. The taxpayer appealed to the Eleventh Circuit.[13]

WRJ argued that the late assessment created an overpayment of taxes under section 6401(a),[14] thereby entitling WRJ to a refund. Section 6401(a) defines the term "overpayment" to include "that part of the amount of the payment of the internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto."[15] Because the Service assessed the amount the taxpayer actually paid plus an additional amount after the limitations period had expired, WRJ argued that the late assessment created an overpayment.[16]

The court acknowledged that a literal reading of the statute supported the taxpayer's argument, but noted that the real issue was "whether . . . payments, properly owed and paid within the [statute of] limitations period, somehow became 'overpayments' merely because the IRS did not get around to assessing liability for them until after the limitations period expired."[17] Recognizing this as an issue of first impression in the Eleventh Circuit, the court followed other circuit court decisions, which have consistently answered this question in the negative.[18]

In disregarding the literal reading of section 6401(a), the Eleventh Circuit invoked the United States Supreme Court's decision in *Lewis v. Reynolds*[19] by holding that "'a taxpayer's claim for refund must be reduced by the amount of the correct tax liability for the taxable year, regardless of the fact that the Commissioner can no longer assess any deficiency for the taxable year.'"[20] Following the Supreme Court's holding, the Eleventh Circuit noted that "'an assessment is not a

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12. *Williams-Russell*, 371 F.3d at 1351-52; I.R.C. § 6511 (2000).
13. *Williams-Russell*, 371 F.3d at 1351.
14. I.R.C. § 6401(a) (2000).
15. *Id.*
16. *Williams-Russell & Johnson, Inc.*, 371 F.3d at 1352.
17. *Id.*
18. *Id.* at 1352-53. *See* Moran v. United States, 63 F.3d 663, 666 (7th Cir. 1995), *overruled in part by* 268 F.3d 497 (7th Cir. 2001); Ewing v. United States, 914 F.2d 499, 501 (4th Cir. 1990); Crompton & Knowles Loom Works v. White, 65 F.2d 132, 133-34 (1st Cir. 1933).
19. 284 U.S. 281 (1932).
20. *Williams-Russell*, 371 F.3d at 1353 (quoting Bachner v. Commissioner, 109 T.C. 125, 130 (1997), *aff'd*, 172 F.3d 859 (3rd Cir. 1998)).

prerequisite to tax liability . . . [but] only a formal determination that a taxpayer owes money.'"[21] The court determined that section 6501[22] of the Code simply prohibits the Service from forcibly collecting taxes after the expiration of the statute of limitations.[23] The court decided that section 6401[24] does not allow a taxpayer to recover taxes correctly owed and paid.[25]

In light of its holding, the Eleventh Circuit did not reach the question of whether, if the taxpayer were due a refund under section 6401, the three-year limitations period of section 6511 would nevertheless bar that refund. However, the court indicated that it likely would rule in favor of the Service on that issue because the United States Supreme Court in *United States v. Dalm*[26] decided a similar issue—whether the statute of limitations under section 6511 runs from the payment or the assessment of the tax—against the taxpayer.[27]

*B. Sentence Enhancement Due to Obstruction of Justice is Not Double Counting Under Federal Sentencing Guidelines*

In *United States v. Uscinski*,[28] the Eleventh Circuit upheld a district court's enhancement of a defendant's criminal sentence for obstruction of justice when the defendant made false statements to law enforcement officials to conceal the defendant's crime of tax evasion.[29] The court reasoned that the false statements were not included in the sentencing calculation for tax evasion.[30]

In 2002 Henry Uscinski ("Uscinski") pleaded guilty to tax evasion under section 7201[31] because he willfully filed a false tax return for the 1996 tax year. Between August and November 1996, Uscinski withdrew approximately $1.5 million from a client's account for Uscinski's personal

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21. *Id.* (quoting *Moran*, 63 F.3d at 666).
22. I.R.C. § 6501 (2000).
23. *Williams-Russell*, 371 F.3d at 1353.
24. I.R.C. § 6401 (2000).
25. *Williams-Russell*, 371 F.3d at 1353.
26. 494 U.S. 596 (1990).
27. *Williams-Russell*, 371 F.3d at 1353 n.2 (citing *Dalm*, 494 U.S. at 609 n.7).
28. 369 F.3d 1243 (11th Cir. 2004).
29. *Id.* at 1247.
30. *Id.*
31. I.R.C. § 7201 (2000). Section 7201 provides:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

*Id.*

use. Uscinski did not report the funds as income on his 1996 federal income tax return.[32]

In 1997 the federal government learned of Uscinski's control over the client's account and the transfers of funds. When the government asked about the transfers, Uscinski lied about the purpose for the transfers, stating that the money was used to support his client's family. After an investigation with the help of foreign governments, the United States government discovered that the money had actually been used for Uscinski's personal benefit. The government charged Uscinski with tax evasion, to which he pleaded guilty. The Pre-Sentencing Investigation report recommended, and the district court imposed, a two-level increase for obstruction of justice.[33] The U.S. Sentencing Guidelines Manual section 3C1.1[34] provides a two-level enhancement if "the defendant willfully obstructed or impeded, or attempted to obstruct or impede, the administration of justice during the course of the investigation, prosecution, or sentencing of the instant offense of conviction."[35] Application note 4(g)[36] provides that the enhancement for obstruction of justice may apply if a defendant made a "materially false statement to a law enforcement officer . . . that . . . significantly obstructed or impeded the [official] investigation."[37] Uscinski argued, among other things, that the district court erred in imposing an enhancement for obstruction of justice because "imposition of the enhancement constituted impermissible double counting."[38]

Uscinski argued that his false statements were an attempt to evade tax, which was exactly the kind of harm already factored into the sentencing guidelines for tax evasion; thus, enhancing the sentence for making the false statements would be "double counting."[39] Impermissible double counting of enhancements under the Sentencing Guidelines occurs "'when one part of the Guidelines is applied to increase a defendant's punishment on account of a kind of harm that has already been fully accounted for by application of another part of the Guidelines.'"[40] According to the Eleventh Circuit, the guideline calculation for tax evasion—U.S. Sentencing Guideline Manual section 2T1.1[41]—

32. *Uscinski*, 369 F.3d at 1245-46.
33. *Id.* at 1246.
34. U.S. SENTENCING GUIDELINES MANUAL § 3C1.1 (2004).
35. *Id.*
36. *Id.* cmt. n.4(g).
37. *Id.*
38. *Uscinski*, 369 F.3d at 1246.
39. *Id.*
40. *Id.* (quoting United States v. Naves, 252 F.3d 1166, 1168 (11th Cir. 2001)).
41. U.S. SENTENCING GUIDELINES MANUAL § 2T1.1 (2004).

did not take into account Uscinski's statements because those statements were not part of Uscinski's offense of tax evasion under section 7201.[42]

According to the Eleventh Circuit, false statements are sometimes part of the offense of tax evasion under section 7201,[43] but "when tax evasion involves the filing of a fraudulent tax return, the offense is complete upon filing."[44] The court reasoned that, because Uscinski's tax evasion was complete upon the filing of his tax return, his false statements to the government were not a continuation of his crime.[45] On the contrary, false statements constituted a separate harm for which an enhancement was appropriate.[46]

### C. *Definition of "Tractor" Under Section 4051(a)(1)(E)*

In *Horton Homes, Inc. v. United States*,[47] the Eleventh Circuit reversed a lower-court decision holding that "toters" used to transport manufactured homes were subject to a twelve percent federal excise tax as "tractors" under section 4051(a)(1)(E).[48] The Eleventh Circuit reasoned that, while the toters qualified as tractors under the regulatory definition of that term, they did not meet the statutory definition of "tractor."[49]

Horton Homes, Inc. ("Horton") purchased certain vehicles, known as toters, to transport manufactured homes from the plant where the homes were built to retail dealers of the homes.[50] Section 4051(a)(1)[51] imposes an excise tax on the "first retail sale" of various vehicles and vehicle components, including "[t]ractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer."[52] From 1963 to 1982, "tractor" was defined in regulations that generally recited the statutory definition. In 1983 the Treasury Department promulgated a new regulatory definition of "tractor" for purposes of section 4051(a)(1)(E):

> The term "tractor" means a highway vehicle primarily designed to tow a vehicle, such as a trailer or semitrailer, but does not carry cargo on

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42. *Uscinski*, 369 F.3d at 1247.
43. *Id.* (citing United States v. Winfield, 960 F.2d 970, 973 (11th Cir. 1992)).
44. *Id.* (citing Sansone v. United States, 380 U.S. 343 (1965)).
45. *Id.*
46. *Id.* at 1248 (citing United States v. Sabino, 307 F.3d 446, 451 (6th Cir. 2002)).
47. 357 F.3d 1209 (11th Cir. 2004).
48. *Id.* at 1212-13; I.R.C. § 4051(a)(1)(E) (2000).
49. *Horton Homes*, 357 F.3d at 1212.
50. *Id.* at 1210.
51. I.R.C. § 4051(a)(1) (2000).
52. I.R.C. § 4051(a)(1)(E).

> the same chassis as the engine. A vehicle equipped with air brakes and/or towing package will be presumed to be primarily designed as a tractor.[53]

The Service determined that Horton's toters fell within the regulatory definition of a tractor for purposes of section 4051 and assessed the twelve percent excise tax on the toters from 1989 until 1995. Horton filed a claim for a refund of the excise taxes paid and sought a judgment that the toters would not be subject to the tax in the future.[54]

The district court ruled that the toters purchased by Horton were tractors within the regulatory meaning of the term, and thus were subject to the federal excise tax.[55] The district court did not address whether the regulations comported with the statutory requirements, noting that "Congress has delegated to the Secretary of the Treasury, not to [the courts] the task of administering the tax laws of the Nation."[56]

On appeal, the Eleventh Circuit applied the two-part test the United States Supreme Court articulated in *Chevron, U.S.A. v. Natural Resources Defense Council, Inc.*[57] to the Treasury Department's regulatory interpretation of the statute.[58] Under this test, as the Eleventh Circuit explained in *Southern Co. v. F.C.C.*,[59] a court must first:

> ascertain whether Congress has spoken unambiguously "to the precise question at issue." If the language of the statute is unambiguous, we go no further, for we must give effect to clear congressional intent. If, however, we determine that Congress's intent is ambiguous as to the question at issue, we must move on to the second step of the Chevron test and ask whether the agency's interpretation of congressional intent is reasonable.[60]

The Eleventh Circuit examined the statutory language of section 4051(a)(1)(E) to determine if the language clearly states the kinds of tractors that Congress intended to make subject to the twelve percent excise tax.[61] The Eleventh Circuit observed that the statutory language limits the kinds of tractors subject to the excise tax to "'[t]ractors of the

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53. Treas. Reg. § 145.4051-1(e)(1)(i) (as amended 2000).
54. Horton Homes, Inc. v. United States, 90 A.F.T.R.2d (RIA) 7548, 7549 (M.D. Ga. 2002).
55. *Id.* at 7550.
56. *Id.* (quoting Commissioner v. Portland Cement Co., 450 U.S. 156 (1981)).
57. 467 U.S. 837 (1984).
58. *Horton Homes*, 357 F.3d at 1211.
59. 293 F.3d 1338 (11th Cir. 2002).
60. *Id.* at 1343.
61. *Horton Homes*, 357 F.3d at 1212.

kind chiefly used for highway transportation in combination with a trailer or semitrailer.'"[62] The Service admitted in its brief and at oral argument that Horton's toters could not tow trailers or semitrailers; they were used exclusively to transport manufactured homes.[63] The Eleventh Circuit concluded that Horton's toters could not be "of the kind chiefly used . . . in combination with a trailer or semitrailer," and therefore did not fall within the statutory category of tractors subject to the tax.[64] The toters, thus, were not subject to the tax, notwithstanding that they fell within the regulatory definition of a tractor.[65] The Eleventh Circuit concluded that to hold otherwise would stretch the statutory language beyond the clearly expressed congressional intent.[66]

## III. DISTRICT COURT CASES

### A. *Application of Communications Excise Tax to Long-Distance Telephone Service*

In *American Bankers Insurance Group, Inc. v. United States*,[67] the United States District Court for the Southern District of Florida held that the federal excise tax on communications services under section 4251[68] applied to long-distance telephone service that was billed according to toll charges that varied by time alone and not by distance.[69] The court's decision has not been followed by other district courts that have considered this issue, and its appeal is currently pending before the Eleventh Circuit.

American Bankers Insurance Group, Inc. ("ABIG") is a Florida corporation headquartered in Miami. ABIG purchased international, interstate, and intrastate long-distance telephone service from AT&T from October 1998 through March 2002. ABIG paid a uniform toll rate for all interstate calls made within the United States, uniform toll rates for all intrastate long-distance calls, and toll rates for international calls that varied only according to the country to which the calls were placed. AT&T collected the federal excise tax under section 4251 on all of these telephone services and remitted the tax to the Service. On February 22,

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62. *Id.* (citation omitted).
63. *Id.*
64. *Id.*
65. *Id.*
66. *Id.*
67. 308 F. Supp. 2d 1360 (S.D. Fla. 2004), *appeal docketed*, No. 04-10720-EE (11th Cir. Feb. 17, 2004).
68. I.R.C. § 4251 (2000).
69. *Am. Bankers*, 308 F. Supp. 2d at 1365.

2002, ABIG filed claims with the Service for a refund of $288,496.10 for the federal excise taxes paid from October 1998 through September 2001, and subsequently filed an additional claim for refund of the federal excise taxes paid from October 2001 through March 2002. The Service did not respond to either claim and ABIG filed suit on July 8, 2003.[70]

Section 4251(a) imposes a three percent federal excise tax on communications services.[71] Section 4251(b)(1) defines communications services to include "local telephone service," "toll telephone service," and "teletypewriter exchange service."[72] The court focused on whether the long-distance services AT&T provided to ABIG qualified as "toll telephone service."[73] Section 4252(b) defines toll telephone service as:

> (1) a telephonic quality communication for which (A) there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication and (B) the charge is paid within the United States, and
> (2) a service which entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radio telephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.[74]

The parties focused on the first category of services (described in section 4252(b)(1)) as more likely to apply to the services purchased by ABIG. ABIG contended that the statutory definition requires that, to be taxable as a toll telephone service under section 4252(b)(1), the toll charge for the service must vary as a function of both time and distance. The Service argued that the statutory language was ambiguous and that the congressional intent behind the provision was to tax all long-distance telephone service.[75]

The court noted that under applicable Eleventh Circuit law, a court may look to evidence of congressional intent outside the statutory language when interpreting a federal statute only if "'(1) the statute's language is ambiguous; (2) applying [the statute] according to its plain meaning would lead to an absurd result; or (3) there is clear evidence of

70. *Id.* at 1362-63.
71. I.R.C. § 4251(a).
72. I.R.C. § 4251(b)(1).
73. *Am. Bankers*, 308 F. Supp. 2d at 1363.
74. I.R.C. § 4252(b) (2000).
75. *Am. Bankers*, 308 F. Supp. 2d at 1362.

contrary legislative intent.'"[76] The court thus examined whether the statutory language was ambiguous and concluded that the word "and" in the phrase "varies in amount with the distance and elapsed transmission time" was ambiguous.[77] The court acknowledged that the word "and" is generally used conjunctively in a statute, but cited a string of cases in which the word "and" may have been used disjunctively—that is, to mean any or all of a series of categories.[78] Indeed, the court observed that later in the same section, the word "and" was used to link section 4252(b)(1) and (b)(2) and that a service could not literally qualify under both such subsections at the same time.[79] This suggested to the court that the word "and" was intended to be disjunctive in that case.[80] The court reasoned that "and" might also have been intended disjunctively in the phrase "varies in amount with the distance and elapsed transmission time," and therefore, the court looked to the provision's legislative history to determine congressional intent.[81]

The court noted that the definition of toll telephone service was amended in 1965 to conform to the types of long-distance service offered by AT&T.[82] In 1965 AT&T offered two types of service. In the first type of service, described in section 4252(b)(1), the toll charges imposed by AT&T for long-distance telephone service did, in fact, vary according to both time and distance. The second type of service (referred to as "WATS"), described in section 4252(b)(2), provided the subscriber the right to make either unlimited long-distance calls or calls up to a certain hourly limit upon payment of a monthly fee.[83] Because AT&T had a virtual monopoly on long-distance telephone service in 1965, the court concluded that by including all types of long-distance service offered by AT&T at the time, Congress must have intended to make clear that all long-distance telephone service was to be taxed as "toll telephone service."[84] The court did not address the argument that because AT&T's toll charges for long-distance service in 1965 varied according to both distance and time, Congress meant precisely what it said and intended to tax long-distance telephone service for which toll charges varied by both distance and time.

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76. *Id.* at 1364 (quoting Moore v. Am. Fed. of Television & Radio Artists, 216 F.3d 1236, 1244 (11th Cir. 2000)).
77. *Id.*
78. *Id.* at 1364-65 (citing, e.g., United States v. Fisk, 70 U.S. (3 Wall.) 445, 447 (1865)).
79. *Id.* at 1365.
80. *Id.*
81. *Id.*
82. *Id.* at 1367, 1369.
83. *Id.* at 1367.
84. *Id.* at 1365-66.

Furthermore, the court noted that the legislative history of subsequent re-enactments of the tax appeared to equate long-distance telephone service with toll telephone service, suggesting that Congress intended to include all forms of long-distance telephone service within the definition of toll telephone service.[85] Additionally, the court noted that in 1979 the Service issued Revenue Ruling 79-404,[86] which interpreted the statutory language to apply to long-distance service for which the toll charges varied only according to time.[87] While a revenue ruling is subject to deference only to the extent of its ability to persuade,[88] the court reasoned that Revenue Ruling 79-404 was subject to deference because it persuasively analyzed the congressional intent behind the provision.[89]

Finally, the court suggested that to interpret the statute in the manner suggested by ABIG would effectively read section 4252(b)(1) out of the Code because most toll charges for long-distance service now vary solely by time (and not by distance), and thus, would not be subject to the tax under ABIG's interpretation.[90]

The opinions of other courts appear to weigh against the district court's conclusion in *American Bankers*. Six federal trial-level courts in other circuits have subsequently considered this issue, and they have all concluded that the statutory language does not apply to long-distance service for which the toll charge varies only by time.[91] In other words, the courts have concluded that the statutory language requires that the toll charge vary by both distance and time.[92] The other trial-level courts have found the statutory language unambiguous and have stated that if Congress intends to tax long-distance service for which the toll charge varies only by time, it must amend the statute.[93]

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85. *Id.* at 1373.

86. Rev. Rul. 79-404, 1979-2 C.B. 382 (1979).

87. *Am. Bankers*, 308 F. Supp. 2d at 1370-71.

88. *Id.* at 1371 (citing Commissioner v. Schleier, 515 U.S. 323 (1995)).

89. *Id.* at 1371-72.

90. *Id.* at 1369.

91. *See* Reese Bros. v. United States, 94 A.F.T.R. (RIA) 7229, 7242 (W.D. Pa. 2004); Fortis, Inc. v. United States, 94 A.F.T.R. (RIA) 6005 (S.D.N.Y. 2004); Office Max, Inc. v. United States, 309 F. Supp. 2d 984, 993 (N.D. Ohio 2004); Amtrak v. United States, 338 F. Supp. 2d 22, 26 (D.D.C. 2004); Honeywell Int'l, Inc. v. United States, 2005 WL 375601 (Fed. Cl. Feb. 16, 2005); America Online, Inc. v. United States, 2005 WL 741847 (Fed. Cl. Mar. 30, 2005).

92. *See Reese Bros.*, 94 A.F.T.R. at 7242; *Fortis*, 94 A.F.T.R. at 6005; *Office Max*, 309 F. Supp. 2d at 993; *Amtrak*, 338 F. Supp. 2d at 26.

93. *See Reese Bros.*, 94 A.F.T.R. at 7242; *Fortis*, 94 A.F.T.R. at 6005; *Office Max*, 309 F. Supp. 2d at 994; *Amtrak*, 338 F. Supp. 2d at 27-28.

The court in *American Bankers* applied policy considerations in disregarding the literal language of the statute so the tax could be collected in that case,[94] but it appears to have missed a larger policy issue raised by the case. The technologies and business models for providing telecommunication services have changed dramatically over the past several decades, most notably with the introduction of voice over internet protocol services, and it is not entirely clear whether Congress intends to tax any or all of the new services. The statutory definition of communication services was crafted to fit a very different telecommunications landscape—a market dominated by a single, large company. The communications industry today is comprised of multiple competitors, both large and small. By failing to create a set of broader rules that addresses the multiplicity of technologies and business models in the current telecommunications landscape, Congress inadvertently may skew the competitive landscape by creating arbitrary tax advantages for certain technologies or business models over others. A policy-based judicial broadening of the existing rules may only delay the response needed from Congress, and therefore, may ultimately turn out to be harmful from a policy perspective.

*B. Employee Leasing Company Held to be Co-Employer for Purposes of Withholding Taxes.*

In *United States v. Total Employment Co.*,[95] the United States District Court for the Middle District of Florida overturned a decision of the bankruptcy court and held that an employee leasing company was an "employer" of the leased employees for purposes of employment withholding taxes.[96]

Total Employment Company ("TEC") is an employee leasing company that leased employees to various client companies. In September 2002 TEC filed a petition for relief under Chapter 11 of the Bankruptcy Code,[97] and the Service subsequently filed a proof of claim and amended proof of claims for unpaid federal employment taxes for employees leased by TEC to four client companies. The bulk of the claim related to employees leased to subsidiaries of American Enterprise Solutions, Inc. ("AESI"), and the court treated the employees leased to AESI as exemplary of the employees in the other cases.[98]

94. *Am. Bankers*, 308 F. Supp. 2d at 1366-67.
95. 305 B.R. 333 (M.D. Fla. 2004).
96. *Id.* at 341.
97. As used herein, the term "Bankruptcy Code" refers to 11 U.S.C. §§ 101-1330 (2000).
98. *Total Employment Co.*, 305 B.R. at 336-37.

The Florida statute that governs the conduct of employee leasing companies provides that the leasing contract must contain a provision that the leasing company: "(b) assumes responsibility for the payment of wages to the leased employees without regard to payments by the client to the leasing company" and "(c) assumes full responsibility for the payment of payroll taxes and collection of taxes from payroll on leased employees."[99]

Thus, the contract between TEC and AESI provided that "TEC assumes responsibility for the payment of wages to the leased employees without regard to payments by [AESI] to TEC and TEC assumes full responsibility for the payment of payroll taxes and collection of taxes from payroll on leased employees."[100] The contract also provided that if the contract were terminated, AESI would assume "all federal, state and local obligations of any employer to the employees which are not in conflict with state or federal law, and shall immediately assume full responsibility for providing workers' compensation coverage," and that TEC would be immediately released from these obligations as permitted by law.[101]

During 1999 AESI fell behind in its payments to TEC, and TEC paid AESI's employees' wages on AESI's behalf. In January 2000 TEC paid the AESI employees' wages for approximately two weeks out of its own funds without requiring advance payment by AESI. TEC did not pay federal employment taxes on the wages it paid during those two weeks. Thereafter, TEC insisted upon receiving payment for net payroll and certain benefits from AESI prior to issuing payroll checks. TEC neither required AESI to remit taxes nor paid the payroll taxes itself.[102]

TEC attempted to shift the burden of paying the employment taxes to AESI by drafting an addendum to the contract that stated:

> As a result of the agreement previously entered into between TEC and AESI for professional employer services, and in consideration for the continued extension of credit to AESI by TEC in regards to payment for services rendered, AESI agrees to reimburse TEC for all payroll tax penalties arising from TEC not being able to meet [AESI's] tax payment requirements.[103]

TEC continued to pay wages to the employees it leased to AESI until the contract was terminated in November 2000. Although TEC reported

99. Fla. Stat. § 468.525(4)(b)-(c) (2004).
100. *Total Employment Co.*, 305 B.R. at 335-36.
101. *Id.*
102. *Id.*
103. *Id.* at 337.

withheld income taxes and social security (FICA) taxes, it made several late payments and failed to deposit over $1.9 million in payroll taxes. Because of the underpayments, the Service claimed penalties and interest in addition to the deficiency.[104]

TEC argued that it was not required to withhold employment taxes because it was not an employer for purposes of withholding taxes. The Service and TEC stipulated that AESI was the common law employer of the employees, and as such, had a non-delegable duty to withhold employment taxes on wages paid to the employees. Because TEC was not the common law employer of the employees, it could only be an employer for purposes of section 3401(d)[105] if TEC was in control of the payment of wages.[106] Section 3401(d) defines "employer" in relevant part as:

> the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that-
> (1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" . . . means the person having control of the payment of such wages.[107]

In *Earthmovers, Inc. v. United States (In re Earthmovers, Inc.)*,[108] the bankruptcy court considered the same issue and concluded that the leasing company was a "co-employer" of the workers, and that the Service could look to both the leasing company and the client company for payment of the taxes but could only collect once.[109]

TEC argued that because AESI was obligated to advance the funds for the payment of the wages, AESI, and not TEC, was in control of the payment of the wages.[110] In *Otte v. United States*,[111] however, the Supreme Court determined that section 3401(d)(1) was intended to place responsibility for withholding at the point of control—the point of actual payment of wages.[112] Following this reasoning, the district court

104. *Id.*
105. I.R.C. § 3401(d) (2000).
106. *Total Employment Co.*, 305 B.R. at 338.
107. I.R.C. § 3401(d).
108. 199 B.R. 62 (Bankr. M.D. Fla. 1996).
109. *Total Employment Co.*, 305 B.R. at 330. TEC argued that the conclusion that the leasing company in *Earthmovers* was an employer for purposes of § 3401(d) was dicta because the taxpayer in that case conceded its liability for the taxes. The district court found the reasoning in *Earthmovers* persuasive, however, and followed that reasoning. *Id.*
110. *Id.*
111. 419 U.S. 43 (1974).
112. *Id.* at 50-51.

concluded that the person that actually makes the payment to the employee is the employer and is, therefore, responsible for withholding employment taxes.[113] Because TEC had control of the payment of wages under Florida law and its contract with AESI, it was an employer under section 3401(d)(1) and had an obligation to withhold employment taxes.[114]

TEC also argued that the structure of Florida Statutes section 468.525(4)[115] suggested that the employee leasing company did not have an obligation to pay the payroll taxes unless the client company first paid the amount of those taxes to the employee leasing company.[116] In support of this argument, TEC noted that Florida Statutes section 468.525(4)(b) states that wages are to be paid by the employee leasing company "without regard to the payments by the client to the leasing company."[117] The phrase "without regard to payments by the client to the leasing company," however, does not modify the leasing company's responsibility to pay payroll taxes and collect taxes from the payroll of the leased employees.[118]

The court rejected this argument for two reasons.[119] First, the statute placed full responsibility on the leasing company to pay the payroll taxes without qualification.[120] Second, because TEC controlled the payment of wages, it would be liable for withholding the federal payroll taxes regardless of whether the Florida statute imposed that obligation.[121]

Finally, TEC argued that it had an agreement with AESI that, because AESI was not paying the payroll taxes in advance, TEC would not make payment of payroll taxes to the Service.[122] The court rejected this argument as a violation of Florida law, which requires all leasing companies to pay the payroll taxes.[123] Any contract purporting to shift responsibility for paying payroll taxes away from the leasing company would violate the statute, and therefore, would be void.[124]

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113. *Total Employment Co.*, 305 B.R. at 339.
114. *Id.*
115. Fla. Stat. § 468.525(d) (2004).
116. *Total Employment Co.*, 305 B.R. at 339.
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.* at 341.

The court concluded that TEC, along with AESI, was responsible for the payroll taxes but that, as between TEC and AESI, AESI had the ultimate responsibility and would be liable to TEC if and when TEC paid the taxes to the Service.[125]

### *C. Service Must Consider a Debtor's Offer of Compromise*

In *IRS v. Holmes*,[126] the United States District Court for the Middle District of Georgia concluded that the Service must consider an offer in compromise from a debtor in bankruptcy proceedings according to the same procedures it uses to consider offers of compromise from any other taxpayer.[127]

William K. Holmes ("Holmes") was a debtor in Chapter 11 proceedings before the United States Bankruptcy Court for the Middle District of Georgia. In 2000 Holmes had approximately 3.2 million shares of WorldCom stock in a margin account. As WorldCom's share price fell, Holmes's broker sold shares to cover the margin calls, generating significant taxable gains for Holmes but failing to generate any cash to pay the taxes due on such gains. On July 1, 2002, Holmes filed a bankruptcy petition seeking relief under Chapter 11 for a plan of liquidation.[128]

The Service filed an amended proof of claim in the bankruptcy proceeding, which included a priority claim for income tax and interest totaling $9,372,245.01, and a general unsecured claim for $920,462.40 for penalties pertaining to the tax due. Holmes submitted an offer in compromise to the Service to pay $621,326 in satisfaction of the Service's claim against him. The Service informed Holmes that it would not process the offer because it has a policy against considering any offers of compromise made by persons involved in bankruptcy proceedings.[129]

Holmes asked the bankruptcy court to enter an order requiring the Service to consider the offer in compromise. The bankruptcy court granted the motion, holding that § 105 of the Bankruptcy Code[130] authorized the bankruptcy court to direct the Service to process and consider Holmes's offer.[131] Under § 105 of the Bankruptcy Code, a bankruptcy court "may issue any order, process or judgment that is

125. *Id.*
126. 309 B.R. 824 (M.D. Ga. 2004).
127. *Id.* at 828.
128. *Id.* at 826.
129. *Id.*
130. 11 U.S.C. § 105 (2000).
131. *Holmes*, 309 B.R. at 827.

necessary or appropriate to carry out the provisions of" the Bankruptcy Code.[132]

The Service appealed the order to the district court and argued that the bankruptcy court could not order the Service to discharge Holmes's tax liability.[133] The district court rejected this argument, reasoning that the order did not force the Service to discharge the tax liability, but merely to apply the same guidelines to a debtor in bankruptcy as it would to other taxpayers under the offer in compromise provision of section 7122.[134]

The Service also argued that the order exceeded the bounds of § 105 of the Bankruptcy Code.[135] The district court, however, noted that § 105 of the Bankruptcy Code has been broadly construed and found that the order was justified as a means of carrying out the negotiation process implicitly provided for in § 1129 of the Bankruptcy Code.[136] Finally, the district court noted that the order did not force the Service to accept the offer in compromise, but merely to consider it and, thereby distinguished other cases holding that the Service could not be ordered to accept an offer in compromise.[137]

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132. 11 U.S.C. § 105.

133. *Holmes*, 309 B.R. at 827.

134. *Id.* at 828. Section 7122(a) provides:

> The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

I.R.C. § 7122(a) (2000).

135. *Holmes*, 309 B.R. at 828.

136. *Id.* at 828-29. Section 1129 of the Bankruptcy Code governs the plan of settlement and generally contemplates a negotiation process between informed parties. 11 U.S.C. § 1129 (2000).

137. *Holmes*, 309 B.R. at 829 (citing Am. Bicycle Ass'n v. United States (*In re* Am. Bicycle Ass'n), 895 F.2d 1277, 1280 (9th Cir. 1990); Addington v. United States, 75 F. Supp. 2d 520, 524 (S.D. W. Va. 1999); *In re* Davison, 156 B.R. 600, 602 (Bankr. E.D. Ark. 1993)).

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