Taxation Law Reporter

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Message from the Chair

Tiffany Burton

We are pleased to present another issue of the Taxation Law Reporter. We hope you find the articles in this issue interesting and helpful to your practice. I encourage you to reach out to the Section if there is a topic you would like to see covered in the Taxation Law Reporter or a CLE program. I would like to extend a special thank you to the members of the Taxation Section's Newsletter Committee who made this edition possible:

Stephen A. Grim, *Newsletter Committee Chair*
Jake Snow
Mark Lansing

I would also like to thank the current leadership team for their time and dedication to the Taxation Section:

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Hopefully, many of you have been able to join us for the first, introductory installment of our three-part series on S corporations, which is available without charge on the Virginia State Bar website. The next installment will cover: (1) the deemed asset sale option for the sale of S corporation stock and (2) an alternative structure used in S corporation transactions to achieve a tax step-up in the assets of the S corporation. In the third installment, we will cover various equity-based incentive options available for S corporations and specific pitfalls to avoid. We encourage you to take advantage of these programs, which are available to you without additional charge from the Virginia State Bar.

We hope to see you at the Section's Annual Meeting, during the Section Luncheons, at the Virginia State Bar Annual Meeting on Friday, May 31, 2024. If you can join us, please register for the Tax Section luncheon when registering for the conference.

If you need another reason to attend the Virginia State Bar Annual Meeting, this year the Taxation Section is honored to be co-sponsoring a CLE program at the conference – "The Three-Headed Dragon: The Intersections of Real Estate Deeds, Divorce, and Taxes."

In an upcoming issue of the Taxation Law Reporter, we look forward to featuring the winning articles from the Section's inaugural law student writing competition. The Section is very excited about this program so please be on the lookout for our upcoming issues.

Calls to Action:
Our organization thrives from the participation of our dedicated members. The Board of Governors welcomes your participation and engagement in the work we do.

- Do you have an article you would like to publish? We welcome your contributions to future Newsletters, or suggestions for topics and articles.
- Have you considered teaching a CLE course in your area of expertise? We are seeking CLE instructors in a variety of practice areas for the upcoming year.
- Are you looking to get more involved in the Virginia State Bar? Consider joining the Section on Taxation Board of Governors to share your ideas, talents, and leadership as we plan for the future of the organization.

Please contact me (tburton@reesbroome.com) to get involved, or with any questions.

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Identifying and Planning for the Probate Tax

By Peter Holstead Davies

Of all the taxes we encounter, the probate tax is often overlooked. While the tax is effectively only 10 cents for every $133.33 of value of probate assets – and only applies when someone dies – it is easily avoided.

How much is the tax?

Under the Virginia Tax on Wills and Administrations Act, the probate tax is assessed at two levels, the state level and the city or county level. At the state level, "[f]or every $100 of value, or fraction of $100, a tax of 10 cent(s) is imposed."[1] The tax does not apply to estates $15,000 or less in value.[2] At the locality level, cities and counties may impose a tax in an amount equal to one-third of the state tax.[3] So for a probate estate of $1,000,000.00, a state probate tax of $1,000 will be imposed, and the locality may impose a tax of one-third of the state probate tax, resulting in an additional $333.33 tax for a total of $1,333.33. Although this article does not exhaustively cover every jurisdiction in Virginia, the author is not aware of any locality in Virginia that has not opted to impose its one-third share of the state probate tax.

What is included in calculating the tax?

The tax shall be based on the value of "all property, real and personal, within the jurisdiction of the Commonwealth, which shall pass from the decedent to each beneficiary by will or intestacy."[4] The value is determined as of the decedent's time of death.[5] An alternate time of valuation election per Internal Revenue Code § 2032 is allowable.[6]

Paying the probate tax is a cost of admission for someone hoping to become a personal representative (an executor or administrator) of an estate. Per Virginia Code § 58.1-1715, "No one shall be permitted to qualify and act as executor or administrator until the tax imposed by § 58.1-1712 has been paid." The initial probate tax is calculated using the information listed on the probate tax return, a daunting-sounding thing that in reality is a one-page court form available online.[7]

Nuts and Bolts

Because a person hoping to qualify as personal representative may have little to no access to information concerning the value of the decedent's estate, that person would be well advised to make a good faith estimate that is on the low end, based on his knowledge, when filling out the probate tax return. Valuation is recognized as not being a precise science and has elements of subjectivity. (Of course, when actual values of probate assets are known, the actual values should be provided.) This particular suggestion is not to avoid the probate tax — in the event of an overestimate or underestimate of value on the probate tax return, there will be opportunity to take corrective action following the personal representative's qualification[8] — but to make the administration easier for the personal representative all while fully paying the probate tax, as seen below.

The personal representative will eventually have to file an inventory (excepting some instances[9]), often including more information than was initially available when submitting the probate tax return pre-qualification. In the event of an undervaluation, the circuit court clerk collects the additional tax as may be due.[10] For the personal representative, this may be handled simply by writing a check to the clerk for the additional tax. However, for overvaluations (likely the result of an overestimate on the probate tax return), the personal representative, to recover the overpaid taxes, must apply to the Virginia Department of Taxation for a refund of said overpayment, as well as the treasurer of the appropriate city or county.[11] (In instances where the underpayment or overpayment results in a difference of less than $25.00, there is no additional tax owed or refund due.[12]) Practically, it is much easier for the personal representative to write a check for additional tax owed than to try to claw back overpayments.

Planning for the Probate Tax

As described above, erring on the lower end of the valuation spectrum when reporting values of a decedent's probate estate merely kicks the probate tax can down the road, giving someone time to officially qualify as the personal representative, obtain the certificate of qualification to gain access to data concerning the decedent's estate, and make up any probate tax difference after submitting the inventory. But the probate tax can be avoided entirely, legally, and easily.

The probate tax is imposed on those assets "which shall pass from the decedent to each beneficiary *by will or intestacy*."[13] Those assets are commonly referred to as "probate assets." For example, if a decedent owned an investment account but listed no beneficiary on the investment account, that investment account becomes subject to the decedent's will or the laws of intestacy, depending on the decedent's estate plan (or lack thereof). That investment account would be a "probate asset," subject to the probate tax. If, on the other hand, the decedent had an investment account and designated a surviving beneficiary, the value of the investment account is excluded from the calculation of the probate tax because it did not pass to the beneficiary by will or intestacy; rather, it went to the beneficiary directly from the financial institution, avoiding the costs and delays of probate. In that event, the investment account would be a "non-probate asset."

Some common examples of non-probate assets are jointly-owned bank accounts, jointly titled cars, real estate owned as joint tenants with the right of survivorship or tenants by the entirety. Other assets, such as the investment account in the example above, may include solely owned assets with beneficiary designations. Investment accounts with "TOD" (transfer on death) designations and bank accounts with "POD" (pay on death) designations likewise become non-probate assets, passing to the surviving beneficiaries upon the decedent's death. Virginia also allows transfer on death deeds[14], which remove the value of the subject real estate from the calculation of the probate tax.

For individuals who do not feel comfortable with assets being transferred outright to their intended beneficiaries at death, a trust may be appropriate. Testamentary trusts (those established in wills) hold assets that will be have been subject to the probate tax. Living trusts, on the other hand, can be funded directly and avoid the probate tax, among the other reasons to avoid probate in general.

Conclusion

Due to the comparatively modest tax when we consider sales taxes, income taxes, and so on, the probate tax may not seem particularly consequential. But it is very easily avoided. There is no one-size-fits-all approach to reducing or eliminating the probate tax, but there are two sizes that fit most: For those who do not have financially mature beneficiaries, they may want to consider revocable living trusts or other estate planning vehicles that allow for some measure of control beyond the grave while avoiding the costs and delays of probate. Those with financially mature beneficiaries who can handle an outright inheritance may consider ti-

tling assets so they are either jointly owned with the right of survivorship, or are solely owned but will transfer to the beneficiary at the decedent's death. If done correctly, the probate tax can be avoided. ◆

Peter Holstead Davies is a shareholder at the trusts and estates law firm Davies & Davies, located in Lynchburg, Virginia. He has served as the president of the Lynchburg Bar Association and is serving as the president of the Lynchburg Estate Planning Council. Outside of work, Peter and his wife stay busy raising their four children and volunteering in the community.

Endnotes
1 Virginia Code § 58.1-1712
2 *Id.*
3 § 58.1-1718
4 § 58.1-1713(A)
5 § 58.1-1713(B).
6 *Id.* Simply put, an alternate time of valuation election would be considered if the value of the decedent's estate decreased from time of death to six months thereafter. The election could then reduce the estate tax liability at the federal level and the probate tax at the state and local levels.
7 https://www.courts.state.va.us/forms/circuit/cc1651.pdf
8 No one is a personal representative (executor or administrator) until appearing before the circuit court, nearly always in the clerk's office, to take an oath. This oath cannot be administered until the decedent has become a decedent and the probate tax has been paid. Once the personal representative has taken the oath, a "certificate of qualification" will be issued to the personal representative. Armed with the certificate of qualification, the personal representative may then begin the task of collecting data (accessing the decedent's bank accounts, for example) to more accurately and fully re-report the value of the decedent's estate in the form on an inventory, another state form available online.
9 *See, e.g.,* § 64.2-1301 et seq.
10 § 58.1-1717.
11 *Id.*
12 *Id.*
13 § 58.1-1713. Emphasis added.
14 § 64.2-621 et seq.

Generation Station Valuation:

The Market Applies The Income Approach, Not The Cost Approach!

By Mark D. Lansing, Esquire

Despite being rejected by the marketplace, since wholesale electricity markets were deregulated, incredibly electric generation plant property, whether real or personal, continue to be assessed, for taxation purposes, by the assessor (and reviewed by an administrative body, state judicial or administrative tax appeal board ("courts")), applying the cost valuation approach.[1] Why does a valuation methodology that breaks with the practice of experts, buyers, and sellers dominate taxation assessment methodology despite being eschewed in the marketplace? Early case law suggested the nascent electricity market was volatile, making cash flow projections and, thereby, the application of the income approach difficult. These findings, arguably, simply served as a means for the assessor to over value generation plants, showing both assessors and courts simply did not correctly apply the cost approach.

The practical result is that the standard of proof for challenging taxation assessments of electric generation plant property is higher than the preponderance of the evidence standard generally applied to commercial property. The application of the income approach would reduce assessment values for such complex industrial properties. Simply, notwithstanding the deregulated nature of wholesale electricity markets and the voluminous sales of generating assets, the continued application of the archaic and maximum value-seeking cost approach remains the predominant valuation methodology.

A. The Assessment and Challenges

Consideration of challenges in tax assessment cases are guided by the Constitution of Virginia and enabling statutes. The Constitution of Virginia mandates: (1) property must be assessed at its fair market value[2] and (2) provides all property taxes "shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax."[3] The Supreme Court explained that "[t]he dominant purpose of these provisions is to distribute the burden of taxation, as far as is practical, evenly and equitably. If it is impractical or impossible to enforce both the standard[s] . . ., the latter provision is to be preferred as the just and ultimate end to be attained."[4] That is, uniformity in assessment promotes equity in the burden of taxation.[5] Uniformity is an essential element of the assessment of the property of electric suppliers and electric utilities (the corporations providing heat, light, and power by means of electricity).[6] Another axiom of Virginia tax law is that the property be assessed at its highest and best use, which applies to decisions by the State Corporation Commission ("Commission") in its assessment of tangible property.[7] Title 58.1 of the Code mandates the Commission to centrally assess the value of real and personal property of electric suppliers.[8] The electric supplier may contest a Commission tax assessment.[9] Once an electric supplier contests an assessment, the Commission must hear testimony and consider evidence and notify all affected localities.[10] The Commission must adjust the tax if it finds the assessment is excessive or insufficient.[11]

Notwithstanding the market's valuation of generating stations and Supreme Court's recognition of correlating the results of an income approach and a cost approach to arrive at a fair market value of property, [12] the Commission applies the original-cost-less-depreciation method to assess generating equipment, other equipment, and materials.[13]

B. The Standard of Review/Proof

While the Code prescribes the authority of an electric supplier to contest a Commission assessment, the Code does not establish the standard of review for such actions. However, case law provides "[t]he Commission's assessment is presumed correct and the burden is upon the owner of property to show that it is erroneous."[14] "The effect of th[e] presumption is that even if the assessor is unable to come forward with evidence to prove the correctness of the assessment this does not impeach it since the taxpayer has the burden of proving the assessment erroneous."[15] Further, "values are matters of opinion to which no rule of thumb can be applied. Before the valuation fixed by [the Commission] can be lowered by the court, the taxpayer must carry the burden of proving that the property in question is assessed at more than its fair market value . . . ." [16]

The Supreme Court defined "fair market value" as the "sale price when offered for sale 'by one who desires, but is not obliged, to sell it, and is bought by one who is under no necessity of having it.'"[17] In assessing fair market value, the property is valued according to its highest and best use.[18] The assessment of

property is not an exact science; valuing land, buildings and tangible personal property is dependent on many factors; and experts disagree on the best method to establish fair market value.[19] The cost, income, and sales methods are the three valuation methods used to assess fair market value.[20] At the nascent stages of the unregulated market, the Court and Commission upheld the use of a cost less depreciation approach to value electric generation property.[21]

The taxpayer rebuts the presumption by establishing a *prima facie* case that such an assessment is erroneous and, thereafter, demonstrating the property's actual value by a preponderance of the evidence. The *prima facie* case is normally shown by substantial evidence consisting of relevant proof that a reasonable mind may accept as adequate to support a conclusion. The taxpayer must merely demonstrate a valuation that is based on reasonable and competent expert evidence, which applies objective data and sound appraisal theory. Thereafter, the proof of the appropriate valuation becomes one of a preponderance of evidence. Practically, this approach seeks:

(1) To ensure that assessors or appraisers performed their statutory duty. (*i.e.*, ensure they assess a large commercial, industrial or generation property at fair market value);
(2) To treat tax assessment or abatement proceedings as being remedial and, thereby, focus on the value of the property (as opposed to finding means to simply dismiss such proceeding on a technicality); and
(3) To treat all taxpayers equitably, so that each pays their fair and equitable share of taxes.

Notwithstanding that tax assessment proceedings for electric generation property are laborious and time-consuming proceedings, failure to reach fair market value (and thereby, an equitable tax assessment) has and will continue to result in inequitable taxation and, potentially, violations of the constitutional rights of the owners of such property. Such failure results in higher electricity prices for consumers.

D. The Marketplace for Electric Generation Plant Property

If a market exists for property, the valuation of such property should be by the income and sales comparison approaches.[22] Beginning in 1996, following the Federal Energy Regulatory Commission's issuance of Orders 888 and 889, numerous states unbundled and de-regulated at least the wholesale electricity market.[23] As part of that process, utility corporations either totally or partially departed the wholesale electric generation market by divesting their generation assets or by spinning them off into a deregulated and independent power-producing entity. That is, Such deregulation resulted in generation plants being bought and sold..[24] In addition, regional transmission organizations (e.g., PJM, MISO, NYISO) developed, monitoring and maturing the wholesale electricity market, as well as other energy commodities.

E. Valuing the Generating Plant

Most states generally agree that the preferred and best evidence of property value is a recent sale of the subject property between a seller under no compulsion to sell and a buyer under no compulsion to buy.[25] These sales are based solely on the income approach not the cost approach. Today, almost two decades after deregulation started, it is accepted that a market exists for electric generation plant property.[26] As market participants solely determine purchase price, or market value, using the income valuation approach, one would assume that the preferred valuation approach is the income approach, not the cost approach. Yet, assessors and courts remain married to the cost approach, despite both finding it cumbersome and volatile and, therefore, difficult to apply.

Other corporate property is often valued based on the income approach, which takes comparable properties' lease income and deducts operating expenses, which tend to be stable and predictable, and applies a capitalization rate applicable for the area or region in which the property is located. In the case of electric generation plant property, the income approach considers the discounted cash flow of comparable properties. That means both seller and buyer project the properties' revenue, then deduct annually-projected operating expenses. The revenue considered is dependent upon changing supply and demand, fuel prices, availability of sustained wind- and solar-generated power, and retiring of or construction of new electric generation plants. (in particular, wind and solar). With the increased presence of wind and solar, and their volatility of generation, the issue of revenue projection becomes more complex; however, the general impact has been to reduce average electricity prices and capacity prices, and thereby, revenues. Thus, market participants apply the discounted cash flow of comparable properties to determine purchase prices and value in the marketplace.[27]

Before applying the income approach, the initial inquiry is whether the ingredients of the income approach are sufficiently (as opposed to speculatively) in place. Also, the appraiser must recognize that the income approach values the business enterprise, as opposed to just the tangible property. Determining the value of the business enterprise requires the appraiser to deduct the value of any intangible property, as well as allocate the resulting tangible property value between real and personal property.

As the underlying issue is market value, and the marketplace values electric generation by the income approach, the valuation of electric generation plant property for tax assessment purposes should likewise be based on the income approach. Even in applying the cost approach, the assessor must measure more than merely the cost to reproduce of replace the property in question, less physical depreciation. To determine market value by the cost approach, the assessor must consider and deduct all three forms of depreciation: physical, functional, and economic. Yet, generally, neither functional nor economic obsolescence are considered. Thus, the impact of those two forms of obsolescence on the value of electric generation plant property, two factors that are inherent to the market's volatility and that render the cost approach equally volatile to the income approach, are totally missed.

F. Conclusion

The result has been that, as natural gas prices have declined and remained significantly below historical levels since 2008, due to hydrofracking and the resultant surplus of natural gas in the marketplace for about a decade, coal-based generation has declined from being over sixty percent of all electric generation in the United States to under thirty-five percent. In contrast, natural gas-based electric generation in the form of combined cycle gas turbines have supplanted coal generation as the major producer of electricity in the United States.

Wholesale electricity prices have been lower over that decade as combined cycle gas turbines produce electricity in a more efficient and less costly manner than coal. Projections of natural gas prices for the foreseeable future remain at the sustained lower level that has existed in the market since 2008. Combine that with a general surplus of electric generation in major deregulated markets (e.g., NYISO, PJM, ISO-NE, MISO and ERCOT) and the fact that the value of nuclear-, coal-, and combined cycle gas turbine-based electric generation plant property have declined substantially over that same period. Yet, tax assessments of such property have generally remained the same, with any decline not being

appreciable. That means that, generally, electric generation plant property (in particular, that which is coal- and nuclear-based) remains over-assessed, reducing such property's profitability and creating increasing financial hardships related to the ownership and operation of such property. ◆

Endnotes

1 *Gordonsville Energy, L.P. v. State Corp. Comm'n,* Sup. Ct. of Va. Rec. No. 050017, Opinion (2005); *Wheelabrator Portsmouth, Inc.*, Case No. PST-2017-00022 (SCC Opinion February 28, 2020).

2 Va. Const. art. X, § 2, provides:

All assessments of real estate and tangible personal property shall be at their fair market value, to be ascertained as prescribed by law.

3 Va. Const. art. X, § 1, provides in part:

All taxes shall be levied and collected under general laws and shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax . . . .

4 *Smith v. City of Covington,* 205 Va. 104, 108 (1964) (citing *Norfolk v. Snyder,* 161 Va. 288 (1933); *Lehigh Portland Cement Co. v. Commonwealth,* 146 Va. 146 (1926)). *See also, e.g., Bd. of Supervisors of Fairfax Cnty v. Telecotnms. Indus., Inc.,* 246 Va. 472, 477 (1993) (citing *R. Cross, Inc. v. City ofNewport News,* 217 Va. 202, 207 (1976) (quoting *Skyline Swannanoa, Inc. v. Nelson Cnty,* 186 Va. 878, 881 (1947))); *Bd. of Supervisors of Fairfax Cm)/ v. Leasco Realty, Inc.,* 221 Va. 158, 166 (1980).

5 *Southern Ry. v. Commonwealth*, 211 Va. 210, 214 (1970).

6 In 2002 and subsequent years, the Commission employed the same methodologies for assessing the value of electric suppliers' property subject to local taxation that has been used in assessing the value of electric utilities' property. We understand that this uniformity in assessment methodology was intended by the General Assembly. *Application Of Gordonsville Energy, L.P.*, Case No. PST-2002-00046 (SCC December 15, 2004.

7 *Norfolk & W. Ry. v. Commonwealth*, 211 Va. 692, 699 (1971).

8 Code § 58.1-2600 states, in relevant part:

[the Commission] is hereby designated pursuant to Article X, Section 2 of the Constitution of Virginia as the central state agency responsible for the assessment of the real and personal property of all public service corporations, except those public service corporations for which the Department of Taxation is so
designated, upon which the Commonwealth levies a license tax measured by the gross receipts of such corporations. The State Corporation Commission shall also assess the property of . . . every public service corporation in the Commonwealth in the business of furnishing heat, light and power by means of electricity, and each electric supplier, as provided by this chapter.

9 Code §58.1-2670 which states, in relevant part:

Any taxpayer, the Commonwealth or any county, city or town aggrieved by any action of the Commission in the ascertainment of, or the assessment for taxation of, the value of any property of any corporation or company assessed by the Commission, or in the ascertainment of any tax upon any company or corporation of its property, at any time within three months after receiving a certified copy of such assessment of value or tax, may apply to the Commission for a review and correction of any specified item or items thereof after which date the Commission shall have no authority under this section or any other provision of law to receive any application or complaint concerning the assessment of value or tax. Such application shall be in a form prescribed by the Commission and shall set forth with reasonable certainty the item or items, of which a review and correction are sought, and the grounds of the complaint. The application shall also be verified by affidavit.

10 Code § 58.1-2671

11 Code § 58.1-2673

12 Id, 211 Va. at 697, 700-01

13 *Id*, 211 Va. at 700-01

14 *Gordonsville Energy, L.P. v. State Corp. Comm'n,* Sup. Ct. of Va. Rec. No. 050017, Opinion (2005) (citing *Norfolk & W Ry. Co.,* 211 Va. at 695 (1971)).

15 *Norfolk & W. Ry. Co.,* 211 Va. at 695 (1971); *see also Fruit Growers Express Co. v. City of lexandria,* 216 Va. 602, 610 (1976) (citations omitted).

16 *Skyline Swannanoa, Inc.,* 186 Va. at 885 (1947)

17 *Keswick Club v. Cnty of Albemarle,* 273 Va. 128, 136 (2007) (quoting *Tuckahoe Women's Club v. City of Richmond,* 199 Va. 734, 737 (1958))

18 *Shoosmith Bros. v. Cnty. of Chesterfield,* 268 Va. 241, 246 (2004) (citing *Norfolk & W. Ry. Co.,* 211 Va. at 699 (1971))

19 *See Southern Ry. Co. v. Commonwealth,* 211 Va. 210, 214 (1970); *Richmond, Fredericksburg & Potomac R.R. v. State Corp. Comm.,* 219 Va. 301, 313 (1978); *see also City of Richmond v. Gordon,* 224 Va. 103, 112 (1982)

20 *Keswick Club,* 273 Va. at 137 (2007)

21 *See, e.g., Gordonsville Energy, L.P.,* Sup. Ct. of Va. Rec. No. 050017, Opinion (2005) (citing*Norfolk & W. Ry. Co.,* 211 Va. at 697-98, 700-701 (1971)

22 *Gordonsville Energy, L.P. v. State Corp. Comm'n,* Sup. Ct. of Va. Rec. No. 050017, Opinion (2005); *Wheelabrator Portsmouth, Inc.*, Case No. PST-2017-00022 (SCC Opinion February 28, 2020).

23 Some states, like New York, de-regulated the retail electricity market.

24 See, e.g., https://www.nsenergybusiness.com/news/newsus-utilities-rush-to-sell-generation-assets/

25 Gordonsville Energy, L.P. v. State Corp. Comm'n, Sup. Ct. of Va. Rec. No. 050017, Opinion (2005); Wheelabrator Portsmouth, Inc., Case No. PST-2017-00022 (SCC Opinion February 28, 2020).

26 Such sales can be either of individual plants, portions of individual plants, portfolios of generating assets, or equity purchases of independent power producers.

27 Notably, like operating expenses at other commercial properties, operating expenses are fairly stable and predictable.

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LITCs and Volunteer Opportunities

By Neil V. Birkhoff

Introduction

Tax issues are difficult for any taxpayer, but tax issues present special difficulties for low-income taxpayers who may not know of their rights and think they can only get assistance by having to use some of their scant financial resources to hire an expert. More than 133 million people in the United States have incomes below 250% of the federal poverty level. People in this group include young people who may not even show up in government statistics because they stopped looking for jobs that did not exist. Others in this group can include bus drivers, auto mechanics, nurses, teachers and others who may not come to mind when one thinks of a low-income person. The Low-Income Taxpayer Clinic ("LITC") is an organization that can keep these low-income taxpayers afloat when faced with tax issues that could otherwise sink them financially.

Low Income Taxpayer Clinics are programs that provide representation to low income taxpayers in federal (and in some cases, state and local) tax disputes. They are part of a larger universe of programs, including student tax clinics, Volunteer Income Tax Assistance (VITA), and Tax Counseling for the Elderly (TCE), that provide a broad array of tax services to historically underserved populations.

LITCs began in the mid-seventies when several law schools established clinical programs for students interested in tax practice. Law students, with the appropriate certification and under the guidance of tax professors, represent clients before the Internal Revenue Service and the United States Tax Court. The student tax clinics serve dual goals - educating students and encouraging them to contribute to the public good.

In 1992, The Community Tax Law Project ("CTLP") became the first independent (non-academic) LITC in the nation. CTLP is modeled after traditional legal aid societies. It maintains a staff of in-house attorneys, as well as an active panel of volunteer attorneys and accountants who accept cases on a pro bono basis.

IRC Section 7526: A Brief History

The number of LITCs grew slowly through the 1970's, 1980's and into the 1990's. Financial help was needed to start new programs and maintain old ones. With the enactment of Section 7526 of the Internal Revenue Code in 1998, which authorizes the Internal Revenue Service to make matching grants for LITCs, the IRS was given the power to award up to $100,000.00 per year to establish or operate a LITC. In 2019, the IRS's LITC program office awarded nearly $11.7 million in grants to 131 grantees based across the United States, including three that received an award for the first time.

During 1997 and 1998, Congress held numerous hearings leading up to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206). Nina Olson, CTLP's first Executive Director, testified before the House Ways and Means Oversight Subcommittee and the Senate Finance Committee about the importance of low income taxpayer clinics and other taxpayer rights issues.

Congress heeded these calls for equal access to representation in tax disputes. Internal Revenue Code Section 7526, enacted by the IRS Restructuring and Reform Act of 1998 (RRA), authorizes the Secretary of the Treasury to allocate up to $6 million of IRS funding per year for matching grants to "qualified low income taxpayer clinics." Such grants may not exceed $100,000 per clinic per year. Clinics must match IRS funding on a dollar-for-dollar basis, although in-kind contributions can be counted as part of the match. The IRS may award multi-year grants for a period up to three years.

Statutory Definition of a Low Income Taxpayer Clinic

(1) Qualified low income taxpayer clinics must either provide representation to low income taxpayers in controversies involving the IRS or operate programs that inform individuals who speak English as a second language (ESL) about their rights and responsibilities as taxpayers. (Clinics can, of course, provide both of these services.) Qualified clinics must provide such services on a pro bono basis or for a nominal fee. A qualified low income taxpayer clinic includes clinical programs at accredited law, business, or accounting schools and 501(c)(3) organizations that provide representation of low income taxpayers through either in-house staff or referral to qualified representatives.

(2) Qualified clinics must document that their client base satisfies two requirements. First, 90% of all cases open during the grant cycle must involve taxpayers whose income is at or below 250% of the federal poverty guidelines. Second, accepted cases generally should not involve over $50,000 in controversy for any tax year.

(3) Section 7526 provides that eligibility for grant awards shall be determined under the following criteria:
  - (i) the number of taxpayers who will be served by the clinic, including the number of ESL taxpayers in the clinic's geographic area;
  - (ii) the existence of other LITCs serving the same population;
  - (iii) the quality of the LITC program, including staff and volunteer qualifications and the LITC's record, if any, of serving low income taxpayers; and
  - (iv) the clinic's alternative funding sources, including grants and contributions as well as the sponsoring institution's endowment and other resources.

The Impact of LITCs on Fairness to Taxpayers

Professor, and former IRS District Counsel, Keith Fogg, in his 2013 article entitled, "Taxation with Representation: The Creation and Development of Low-Income Taxpayer Clinics," 67 The Tax Lawyer 3 (2013), has noted several ways in which LITCs have positively impacted the tax system by providing fairness to low-income taxpayers as well to the system as a whole.

(1) **LITCs affect the perception of fairness by low-income taxpayers.** In many cases the LITC finds the client totally lost and confused in the process. The client has little or no trust in the IRS and interprets every action by the IRS as an effort to obtain an advantage. LITCs play an important role in explaining the system and the law to their clients in a neutral way. The LITC allows most clients to come out of their experience with the IRS feeling that the system treated them fairly. Thus, LITCs aid the IRS by making it easier to resolve cases, making the resolution more amicable, and promoting the perception of fairness in the system.

(2) **LITCs provide advice to clients to prevent them from having future problems with the IRS.** Even in situations where the LITC cannot achieve a "victory"

for the client, the LITC can explain to the client how to avoid the problem in the future. This educational and advisory function of LITCs represents a key element to the overall fair treatment and the perception of fair treatment of low-income taxpayers.

(3) **LITCs provide individuals with professional legal and accounting advocacy, promoting fairness in the application of the tax laws that cannot exist in an adversarial system without that representation.** The tax system is necessarily an adversarial system. When one party to that system constantly appears unrepresented, the system fails. Thus, the representation of specific low-income taxpayers has an overall beneficial impact on the system. IRS employees receive education on issues that they might not have previously appreciated, and the taxpayer receives the benefit of a competent advocate.

(4) **LITCs advocate for system change in addition to their advocacy for individual clients.** LITCs have a voice in the system for issues impacting low-income taxpayers where no voice previously existed.

Making the tax system fairer for low-income taxpayers also benefits the tax system as a whole. If one party in the tax system feels disenfranchised, that party becomes more likely to take steps to evade taxes in some fashion, thereby placing more pressure on other parts of the system. To the extent that the tax system responds better to the needs for low-income taxpayers, their compliance level should increase, making the whole system work more effectively.

LITCs and the Holistic Delivery of Tax Services to the Low Income Community

LITCs help taxpayers primarily in tax controversies with the IRS and state and local tax authorities. Joint and several tax liabilities can be a lingering trap for spouses who flee abusive marriages. A person may have used retirement benefits for a medical emergency, but failed to address the tax impact. Civil law settlements may have been obtained to address a variety of issues such as from medical illness from working conditions.

The earned income tax credit (EITC), Section 32 of the Internal Revenue Code, is a great resource for working people, but it is a highly scrutinized provision that traps many low-income people in tax disputes. LITCs have been instrumental in preventing EITC issues from catching unsuspecting taxpayers. Without the technical expertise of the LITC, such persons would have an extremely difficult time defending or even understanding all the nuances of EITC disputes.

Where there are no defenses or insufficient defenses to eliminate the tax liabilities, the ability of LITCs to navigate the offer-in-compromise program has led to a much more efficient use of IRS resources as taxpayers become compliant.

The work of LITCs does not stop at client representation in tax controversies. LITCs conducted more than 1,846 educational activities for over 41,800 attendees in 2019 (the year of the last full LITC report from the IRS) and that number is growing. LITC educational programs address filing requirements, tax recordkeeping obligations, family status issues, identity theft, worker classification issues, and other topics that affect low income people. LITCs also serve as front line organizations, seeing and raising issues in need of greater attention.

In addition to helping fund LITCs, the IRS also provides these clinics with a voice to speak to about these issues through its Taxpayer Advocate Service (“TAS”). The TAS Office of Systematic Advocacy hears concerns of LITCs, and that office can address these issues with the IRS on behalf of the LITCs and their low-income taxpayer clients. TAS has advocated before IRS on numerous issues raised by LITCs, and the IRS has listened and acted. For example, further educational outreach has been made by the IRS relating to filling out the Form 2848 Power of Attorney form and how to obtain an individual taxpayer identification number, among other efforts.

Attorneys involved in the delivery of legal services to the poor are now exploring the concept of “holistic” legal services. This approach to poverty law views a legal service organization as a comprehensive support for low income persons who seek to transcend poverty. In essence, the legal service provider focusses simultaneously on the many facets of a client’s life to achieve true change (for the better).

The trend toward holistic legal service delivery helps explain the interest of legal aid societies and other nonprofit community service providers in the low income taxpayer clinic grant program. Whether a case involves proving Earned Income Tax Credit eligibility for a welfare-to-work program participant, obtaining innocent spouse relief for a victim of domestic violence, or closing an offer-in-compromise for a disabled person, substantial benefits are conferred upon low income persons as a result of the LITC’s representation. The resolution of a tax matter often enables the taxpayer to address other problems, such as obtaining better housing with the EITC refund.

Opportunities to Assist

Holistic delivery of tax services also poses a challenge to the tax professionals. There are now low income taxpayer clinics in almost every state in the nation (including Hawaii and Alaska), as well as the District of Columbia. Opportunities now abound for accountants and attorneys to volunteer their services, accepting pro bono case referrals, offering to serve as a mentor to less experienced tax professionals, conducting training seminars and outreach programs, and writing outreach materials. In 2019, over 1,555 volunteers provided 52,564 hours to LITCs. Sixty-five percent of the volunteers were attorneys, CPAs, or EAs.

LITCs are strongly encouraged to develop and maintain a pro bono volunteer panel to whom they may refer taxpayers needing representation, or in the alternative, utilize an existing pro bono panel to which they can refer cases. Pro bono panel members include volunteers (attorneys, CPAs, and EAs) who are qualified to practice before the IRS and the Tax Court or other federal courts. Volunteers also assist LITCs in ways other than by providing representation. For example, at some LITCs, student volunteers provide case support by doing research and organizing tax documentation. Other volunteers help by providing translation and interpretation assistance at community outreach and networking events, clerical support, and website development and maintenance.

Volunteers who know the tax law are always welcome, as LITCs can use pro bono assistance in handling overflow cases. LITCs can also count pro bono hours toward the amount that they must match in order to continue receiving IRS funding. ◆

Neil Birkhoff is a principal in the Roanoke office of Woods Rogers Vandeventer Black. He is a Fellow in the American College of Tax Counsel. He has served in various roles with the Community Tax Law Project and as Visiting Director of the W&L Law School Tax Clinic. He received his B.A. from U.Va., his J.D. from William & Mary, and his LL.M. in Taxation from George Washington University.

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