

A Brief Analysis of Governor Palin's Tax Returns for 2006 and 2007

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The release of an opinion letter by attorney Roger M. Olsen dated September 30, 2008, has stirred up the pot once again about the accuracy of Sarah and Todd Palin's 2006 and 2007 tax returns. Not only that, but Mr. Olsen's letter raises a couple of new issues.

This paper focuses on five problems: three raised in the tax returns and two new ones raised by Mr. Olsen's letter. Here's a summary of the five problems and my conclusions, for those who want to cut to the chase. My analysis will follow.

(1) The Palins did not report as income some \$17,000 that Governor Palin's employer (the State of Alaska) paid her as an "allowance" for her travel. Can they do that? Yes, most likely.

(2) The Palins did not report as income some \$43,000 that the State of Alaska paid the Governor as an "allowance" for her husband and children's travel. Can they do that? No, most likely not.

(3) The Palins deducted \$9,000 on their 2007 return, claiming it was a loss from Mr. Palin's snow machine racing activity. Can they do that? Most likely not, but more info could make the deduction o.k.

If any of the above issues goes against the Palins they then risk getting hit with the section 6662 penalty for "negligence or disregard of rules or regulations."

(4) Can the Palins avoid the section 6662 negligence penalty by claiming that they reasonably relied either (a) on the W-2's sent to them by their employer, which did not reflect either the \$17,000 or the \$43,000, or (b) on their tax return preparer H&R Block, or (c) on Mr. Olsen's opinion letter dated September 30, 2008? The three reliance defenses are unlikely to succeed, but more info may make the (b) defense a good one.

(5) Does Mr. Olsen have any exposure to sanctions by the IRS because of his letter? I believe Mr. Olsen's letter probably violates 31 C.F.R. section 10.35. If so, he would be exposed to possible sanctions from the IRS Office of Professional Responsibility.

In this post I will sometimes refer to the Tax Code, to tax regulations (Treas.Reg), and to court cases. If you want to read any of those sources, Cornell University School of Law keeps a reasonably updated version of the Tax Code here: <http://www4.law.cornell.edu/uscode/26/> The main version posted is the one as of January 2007, but there are links to the updated sections. The Government Printing Office keeps a reasonably updated version of the tax regulations here: <http://www.access.gpo.gov/cgi-bin/cfrassemble.cgi?title=200826> When I reference a court opinion, you will mostly likely have to depend on a law library or access to a commercial database. If you're lucky, you can go to the court's website and find the opinion is posted there.

The Basics: Everything Starts off as Income!

Section 1 of the Tax Code imposes tax on “taxable income.” Section 63 defines that term as “gross income minus the deductions allowed by this chapter.” And § 61 defines “gross income” as “all income from whatever source derived.” The regulations emphasize that taxpayers have gross income when they receive *anything* of economic value, whether in the form of cash, property, or services. See, e.g. Treas.Reg. 1.61-1. The Supreme Court has ruled that gross income means “any undeniable accessions to wealth, clearly realized, and over which the taxpayer [has] complete dominion.” Comm’r v. Glenshaw Glass, 348 U.S. 426 (1955). The form of the wealth does not matter. The source of the wealth does not matter. The accession to it does.

So when a taxpayer receives a payment from his or her employer, that is gross income unless some other Tax Code section allows the taxpayer to exclude that payment from income. Typically, employers pay for their employees services with wages. But employers may also compensate employees with other types of payments. For example, when an employee travels on business for the employer, an employer might well pay the employee’s travel expenses. Those payments are “fringe benefits” and are gross income, according to Treas.Reg. 1.61-17(a)(3), which says that “a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services.”

Some Income Does not Count: Fringe Benefits

Normally, fringe benefits are taxable. But if your employer is just reimbursing you for an expense which you would be able to deduct from income anyway, then section 62 of the Tax Code (and its regulations) cuts taxpayers a break. Rather than making taxpayers report the income when they would just take an equal offsetting deduction, taxpayers are allowed to ignore both the income and deductions. That’s nice. It’s like it never happened. Payment? What payment?

Of course, there are some rules, spelled out in Treas.Reg. 1.62-2. That regulation says the reimbursements have to be made per something called an “accountable plan.” That means that the reimbursement or expense allowance arrangement must meet certain standards. Of particular importance is that there must be controls to prevent employees from getting paid more than their real expenses. Generally, that means employees have to keep track of their expenses. If that is done, Treas.Reg. 1.62-2(c)(4) says that the employee does not have to report the reimbursements as income and no one has to pay social security taxes on them, either. Sweet.

But the most important requirement is that the reimbursed expense has to be otherwise deductible by the taxpayer as a business expense under sections 161 through 197 of the Tax Code. Treas.Reg. section 1.62-2(d). For Palin, that means that the underlying travel expenses for herself and her husband and kids would have to be deductible from her gross income if she did not get reimbursed. If the underlying expenses would not be deductible, then she has to report the reimbursement as income and pay tax on it.

So to see whether Plain has to report either the \$17,000 or the \$43,000 we have to figure out whether she would be able to deduct the “expenses” that these payments were supposed to be reimbursing her for.

Living “On the Fringe” or “The Per Diem Game”

One problem immediately comes to mind: Palin was not really reimbursed for any actual expenses---she cannot show any receipts to justify the \$17,000 or the \$43,000. Instead, she got paid those amounts as an “allowance” based on a \$60 “per diem.” (The facts relating to the \$17,000 and \$43,000 payments are reported here, <http://www.washingtonpost.com/wp-dyn/content/article/2008/09/08/AR2008090803088.html>) Everyone just pretended she spent \$60 per day on meals and incidental expenses. We have no idea what she actually spent. That’s what a “per diem” is all about. It’s a “we’ll pretend you spent this amount” deal. If you actually spend more, too bad, so sad, you don’t get reimbursed. If you actually spend less, then BONUS, you’ve got tax free income.

The problem has an easy solution. Treasury regulations allow employers to reimburse employees for travel expenses under a reasonable per diem arrangement. Treas.Reg. 1.62-2(d); 1.162-17(b)(4). Instead of employees having to preserve every scrap of paper or reconstruct every dime they spent, employers can just pay their employees based on assumed expenses. Per diem’s really simplify life.

Ahhhhh, per diem! Almost ALL employees love to play the “per diem game.” It goes like this: if you are on travel status and get a per diem, then you try to spend as little as possible on the trip so as to maximize...tax-free income! Say you are a lowly professor at some state university and you travel to Washington D.C. Your state allows you a \$64 per-diem there for M&IE. You eat all your meals at Subway for a total of \$20 for the day. You have made \$44, tax free.

Now that’s “living on the fringe.” Whoo-hoo!

To sum up: to the extent that travel expenses are deductible under section 162(a)(2), then payments based on a set per diem for the travel expenses under an accountable plan are excludible from income under section 62(c).

But none of these tax goodies are available if the underlying travel expense is not deductible in the first place. So if Sarah Palin had actually spent \$60 per day on meals and incidental expenses for herself while in Anchorage, then would that be deductible? If so, the \$17,000 payment for her per diem would be tax free. Likewise, if she had actually paid \$60 per day for the first dude and the kids, would that be deductible? If so, then the \$43,000 payment would be tax free.

We have to find some tax provision that justifies a deduction for money that Sarah might have spent (but did not actually spend) on meals and incidental expenses during her 212 days in Anchorage, and for her husband and kids on their own travels. The best place to look is section 162, the “workhorse” of business deductions. Let’s go look.

Where’s Home, Toto?

Again, for Palin to get that \$17,000 and \$43,000 tax free she's got to be able to deduct the expenses it represents under section 162. Section 162 allows taxpayers to deduct the ordinary and necessary expenses of carrying on their trade or business. You say "shucks, she's just an employee." Well, guess what? Employees are in the trade or business of...being an employee! So said the Tax Court. Primuth v. Comm'r, 54 T.C. 374 (1970). And the IRS grumpily agreed about 5 years later. See Rev. Rule 75-120, 1975-1 C.B. 55.

Section 162 allows a deduction for the costs of business travel. The idea is that these expenses are part of the "cost of doing business" and so are deductible from what you make in that business. Expenses which are just the result of personal choice and not business need are not deductible, says section 262. The Supreme Court has said that travel expenses can be deducted when:

- (1) they are reasonable,
- (2) they are incurred "away from home" and
- (3) they are incurred in pursuit of business.

Flowers v. Comm'r, 326 U.S. 465, 470 (1946).

Let's look at each of those requirements as applied to Palin's situation.

(1) First, the per diem here is reasonable. \$60 per day is in line with the federal per diem for Anchorage, which is \$78 per day. See here: <http://perdiem.hqda.pentagon.mil/cgi-bin/pd-rates/opdrates.pl>

(2) Second, it is less clear whether the expenses here ---- the \$17,000 and the \$43,000 --- were incurred "away from home."

Both the IRS and the Courts tend to equate a taxpayer's "home" for tax purposes as where the taxpayer needs to live to earn a living. Home is not where the heart is: it's where the money is. So if a taxpayer chooses to live in a different city than his or her employer's offices, travel to the office is just a loooong commute. For example, in Robertson v. Commissioner, T.C. Memo 1997-526, the taxpayer lived in Oxford, Miss., and traveled to Jackson, Miss. four days a week to do his job as a State Supreme Court Justice. He deducted those travel expenses. The IRS and the Tax Court disallowed those deductions. But since he also taught part-time in a law school in Oxford, he was allowed to deduct his travel costs for the 1 day a week he "traveled" from Jackson to Oxford to teach. So even though Oxford was where he got his mail and where his family was and where his "home" in the ordinary sense was, his "tax home" was Jackson because that is where his principal place of business was.

So where is Palin's tax home? One could reasonably conclude that as Governor of Alaska, her work site is Juneau, the capital city. If that is her "tax home," then travel from it to Wasilla/Anchorage would meet the second of our three requirements of being "away from home."

Where is the first dude's tax home? It sure ain't Juneau. Spouses may have different tax homes from each other. For example in Foote v. Commissioner, 67 T.C. 1 (1976), Mr. Foote's tax home was his ranch and his wife's tax home was Austin, even though they both lived at the ranch. She just had a big commute. In Palin's case, Todd has no business connection to Juneau. I frankly don't know where Todd's tax home might be. I did not analyze that because it does not matter here. The reimbursements were to Governor Palin as an employee of the State of Alaska and not to Todd Palin or her kids, so it is her tax home that is important.

So that takes care of the first two requirements for Palin to get the deduction. Remember, if she gets the deduction, she one step closer to getting tax free income of \$17,000 and \$43,000.

Takin' Care of Bid'ness

(3) NOW we reach the crux of the matter. Assuming that the theoretical expenses Palin incurred were reasonable and were incurred "away from home," were they expenses incurred "pursuit to business"? Here is where there is a big difference between the \$17,000 and the \$43,000. Remember, we are talking about the "trade or business" of Governor Palin here, not the trade or business of the first dude.

As to the \$17,000, Palin has a very plausible claim that she needed to conduct state business in Anchorage during the 54% of the year she spent there. The state maintains an office there for her and she uses it. The state legislature does not meet in Juneau year round and many politicians live in Anchorage. Finally, much of the state's business community appears to be headquartered in Anchorage. These facts (which I collected from Mr. Olsen's letter and from the Washington Post story linked earlier) strongly support a claim that travel to Anchorage was in pursuit of her business as governor. For a more skeptical analysis, Tax Prof. Jack Bogdanski has a great post here: http://bojack.org/2008/09/governor_palin_your_tax_return.html

As to the \$43,000, however, Palin has a very weak claim that her husband's travel meets this requirement of being in pursuit of HER business. The strongest claim I've seen is that it is "expected" that Palin would take Todd and the kids along with her to various political functions across the state or that the first dude would act as her ceremonial surrogate when she could not attend. This is the claim made by her spokesperson, as reported in the Washington Post article linked earlier, and also in Mr. Olsen's letter.

Now, it may well be that the State of Alaska wants to encourage its governors to take their family with them and send their spouses as stand-ins. No one is suggesting that the payment of \$43,000 as a travel allowance for Todd and kids sundry excursions around the state is improper or wrong or anything like that. Gosh, it's a great idea and if the Governor's family is willing to provide their services to the State, then the State should compensate them, don'tcha know.

So it is not the receipt of the money that is the issue. Governor Palin is not Senator Stevens. The issue is whether Palin gets the \$43,000 tax free ---- no income tax, no social security tax, no medicare tax, not a dime. Remember, all payments from an employer to an employee start off being income and taxpayers have to prove up any claim that the payments are tax free. Comm'r v. Schleier, 515 U.S. 323 (1995). Here, Palin's only argument is that the \$43,000 represents a

reimbursement for a theoretical expense that is theoretically deductible and is therefore not required to be reported by section 62(a)(2), as I explain above.

The problem is, this theory runs smack into Tax Code Section 274(m)(3). It does not survive the collision. That section prohibits the deduction of any travel expenses for the SPOUSE or DEPENDENT of a taxpayer unless (a) they are ALSO employees of the employer paying for the trip, (b) are traveling for a bona fide business purpose, and (c) could deduct the travel expenses on their own tax returns (presumably under section 162).

There is no suggestion that either Todd or the kids are employed by the State of Alaska. Maybe they should be. That might go a long way to making this expense deductible and, hence, the reimbursement excludable. It could be a work-around, at least on the first requirement. Of course, then you would have the issue of their travel having a bona fide business purpose. I'll leave that one alone since it is not necessary for resolution of the question here.

Another work-around for the state of Alaska could be to simply provide the travel to Todd and the kids directly. Forget the cash. Just provide the plane and have someone from the state pick up the meals. In that case, although the receipt of the free travel and meals would still be income (to Palin) every bit as much as the cash payments, she could use a different section to exclude the income from her return. She could use section 132(d), which allows employees to exclude "goods or services" provided to them by their employer if the cost of those goods and services would have been deductible by the taxpayer had the taxpayer incurred the expense. The difference here is that nasty Section 274(m)(3) would not apply. Treas.Reg. 1.132-5(t). H.R. Rep. No. 111, 103d Cong., 1st Sess. 645 (1993)(indicating that Congress did not intend section 274 to apply to working condition fringe benefits).

As it stands now, however, the Palins should have reported the \$43,000 in family travel allowances received in 2007 as income. They did not.

The Pleasures of Racing Snow...Machines (Don't call them Snowmobiles)

The third issue raised by the tax return is whether the Palins properly deducted some \$9,000, claiming it as a loss from Todd Palin's racing activity. If his racing activity was a hobby, then he cannot deduct "losses" but if it was a trade or business, he can.

Let's go back the start. Just as ALL payments to a taxpayer start out as income, ALL expenses of a taxpayer start out being non-deductible and it is up to the taxpayer to prove an entitlement to deduct any expense. Section 262. *INDOPCO v. Comm'r*, 503 U.S. 79 (1992).

We have already seen how section 162 allows deductions for expenses related to a trade or business. The basic idea is that the money it takes to make money is deductible from the money you make. (Just keep repeating that sentence and it will make sense after about 20 repetitions).

Losses work the same way. If the expenses of your business are more than your income from that business, then you have a loss and section 165 allows you to deduct that loss.

But what if you have a hobby that happens to produce some income? For example, what if you are a collector of...stamps. From time to time you might sell or trade your stamps and those deals might result in income to you. But since your stamp collecting is not your business you could not deduct your stamp collecting expenses under section 162 and section 262 would deny the deduction for being a personal expense. What can you do?

Section 183 comes to your rescue. It allows hobbyists to deduct the expenses of their hobby from the income the hobby produces even though those expenses would otherwise be non-deductible because of section 262. But 183 helps only up to a point. Taxpayers may not deduct their hobby losses. That is, if their hobby expenses are more than their hobby income, then that loss is not deductible. The point of section 183 is to allow taxpayers to avoid having to pay tax on income when they had to spend money to make that money. Remember, the money you spend to make money should be deductible from the money you make. But 183 does not allow loss deductions because then that would be allowing taxpayers to shelter other income from taxation.

So if Todd Palin's racing activity is a trade or business, the \$9,000 deduction would be proper. If it was a hobby, however, it was an improper deduction.

How do you tell the difference between a hobby and a business? It's not always clear. It often much depends on the facts and circumstances.

Section 183 gives some helpful guidance. If the activity produces a profit in three out of the past five years, then the IRS will presume it to be a trade or business and not a hobby. Since the Palins released only their 2006 and 2007 returns, we cannot apply this test. But Todd Palin did report a profit from the racing activity in 2006, so if he reported a profit from the activity in two more years, going back to 2002, then the \$9,000 loss deduction would most likely be o.k.

If Todd Palin cannot meet the "3 in 5" rule, then the question is a bit messier. The critical question that the IRS and the Courts will ask Todd is whether making a profit was his "predominant, primary, or principal objective" for racing. Wolf v. Commissioner, 4 F.3d 709, 713 (9th Cir. 1993). Treas.Reg. 1.183-2 lists a bunch of other questions that are designed to answer that basic question about the taxpayer's primary objective for doing the activity.

This question about making a profit has nothing to do with the intensity of a taxpayer's feelings about the activity or the esteem with which the taxpayer is held by others engaged in that activity. A group of poker players may include some who are professional and some who are amateur. But they all want to win, and they all value their reputations.

So was Todd Palin into racing in 2007 with the "predominant, primary, or principal objective" of making a buck? Or is it more that he just loves to race, getting immense personal satisfaction from the activity and from winning, with the prize money being a sweet bonus, but not the point of the deal?

I have no idea what the answer is, but here are some data points that lead me to conclude that snow-machine racing is not Todd Palin's business but is his hobby. First, I cannot find any

websites for “professional” snow machine racers. Of course, I might have just missed it. But if there is no professional association, that suggests that there is not enough money in the sport for folks to do it as a business. Second, I cannot find any references to Todd Palin being a “professional” racer that predate Governor Palin’s selection as McCain’s VP running mate. For example, here is a story about his crash in the Iron Dog, but does not suggest that anyone thinks he is a professional racer. <http://www.adn.com/news/alaska/story/316352.html> Again, I might just be a lousy researcher, however.

Third, and most importantly, what does Todd Palin say and do? The determination of whether the racing is a business is really about Todd Palin’s personal intent. Why does he do it? Love of sport or love of lucre? Some more clues may be found in the following interview he had on FOX News, available here: <http://www.foxnews.com/story/0,2933,423102,00.html> :

VAN SUSTEREN: I take it that you like where you live. Look at this spectacular view. How long have you lived here?

PALIN: About six years. And we're very fortunate to be here. And it is nice for the kids in the summertime. *It's a big playground in the wintertime. About five months out of the year, it's a big playground, as well, where we snow machine and ice skate on the lake.*

Then later:

VAN SUSTEREN: How fast is the fastest you've ever gone on this?

PALIN: On this one, this is a 600, so maybe about 104. When we raced 700s, we were getting some pretty good top speeds.

VAN SUSTEREN: Like how top?

PALIN: Oh, you know, about 110, 112.

VAN SUSTEREN: Does the governor know you're doing that?

PALIN: Not all of it, but... (LAUGHTER)

VAN SUSTEREN: I mean, because that's dangerous!

PALIN: *It is, but we all have to have our things that we like to do.*

Then later,

VAN SUSTEREN: So what got you started on this?

PALIN: *I just -- you know, I've been driving snow machines all my life. My dad told me, If you can start it, you can ride it. So I got all my buddies in the neighborhood and we'd start it, you know, the snow machine. And just an avid -- I just love riding snow machines.*

VAN SUSTEREN: What about -- you've got one son, I know, that was just deployed. Is he a snow machine rider, too, or is this just yours?

PALIN: *Yes. I mean, he wasn't a big racer because his sport was hockey. So you know, hockey or ride, but you know, he got a lot of riding in, as well.*

Again, the interview is not conclusive, but it points in the direction that Todd Palin loves riding and racing for its own sake and not for the financial profits he might reap from being good at it.

Riding and racing is something he grew up with and while he earns his living working in Prudhoe Bay and spends four weeks catching fish, snow machine riding and racing is his hobby.

Based on this evidence, I would say that Todd Palin would not be able to prove he was engaged in the sport with the PRIMARY objective of making money. But there may be more information that would enable him to prove he was. The best evidence would be whether he actually made money in two more of the years going back to 2002. Absent that, he has a steep hill to sled.

Were The Palins Negligent in Goofing Up Their Tax Returns?

So the Palins goofed up. They goofed up by failing to report and pay taxes on some \$43,000 in payments that the state of Alaska made to Governor Palin as a travel allowance for her husband and children. They also may have goofed up by claiming a \$9,000 loss deduction for what may be Todd Palin's hobby of snow machine racing.

So what? Well, Section 6662 imposes a 20% penalty on understatements of tax that result from the "negligence or disregard of rules or regulations." Treas.Reg. 1.6662-2(a) defines "negligence" as "any failure to make a reasonable attempt to comply with the provisions of the internal revenue laws or to exercise ordinary and reasonable care in the preparation of a tax return." One failure that triggers the negligence penalty is the failure to have a reasonable basis for a position taken on a tax return. In other words, if you take a skanky enough position on a return, then that's negligence.

So one defense to the negligence penalty is to claim that you had a reasonable basis for the position. It was not skanky. There are more defenses, but let's take this one first.

Can the Palins make that defense? Can they say that they had a reasonable basis for NOT reporting the \$43,000 and for deducting the \$9,000? It would be unlikely. It is not generally reasonable to ignore a statute that directly disallows the position you are taking on the return. So the Palin's failure to obey section 274 will likely be considered negligence. What about the \$9,000. That's a closer call and I cannot tell on the facts I have available.

Even if the Palins were negligent, they have another defense to duck the penalties: they can claim "reasonable cause." This defense would work slightly differently for the \$43,000 omission than for the \$9,000 deduction. For sake of brevity ("too late!" you say), I will just address the \$43,000 omission.

Section 6664 says that if a taxpayer had "reasonable cause" for taking the negligent position, the taxpayer can avoid the penalty. Here, the Palins could argue that they reasonably relied on (a) the W-2 sent by the State of Alaska, (b) their tax return preparer, H&R Block, or (c) the opinion letter from Mr. Olsen.

The reliance on the W-2 defense won't work. Treas.Reg. 1.6664-4(b) says that "A taxpayer's reliance on erroneous information reported on a Form W-2, Form 1099, or other information return indicates reasonable cause and good faith, provided the taxpayer did not know or have reason to know that the information was incorrect. Generally, a taxpayer knows, or has reason to

know, that the information on an information return is incorrect if such information is inconsistent with other information reported or otherwise furnished to the taxpayer, or with the taxpayer's knowledge of the transaction.” Here, the Palins had reason to know the information on their W-2 was incorrect. Further, they had reason to know that the W-2 was inconsistent with other information they had about the \$43,000, namely, the checks they received that made up that \$43,000. Bottom line: you cannot rely on your employer to figure out your taxes for you!

What about H&R Block? Can the Palins point the finger there? Courts regularly find that taxpayers have good cause for taking positions on their return when a tax advisor specifically advises them to take the position. After all, that’s what you pay a tax advisor to do. And there are a whole set of penalties to make tax advisors take responsibility for the advice they give. I’ll get back to that in a moment when I turn to Mr. Olsen’s letter.

The reliance on H&R Block will not likely work, at least based on what facts I see here. Treas.Reg. 1.6664-4(c) says that this defense will not work if the taxpayer did not disclose ALL the relevant information to the tax advisor. So far as I can tell, the Palins just gave the W-2’s to H&R Block and did not say “hey, we also got \$17,000 and \$43,000 and should we be reporting these amounts as income?” But maybe the Palin’s did do that. If so, that would be a factor that would improve their chances. But then they run into another problem. Treas.Reg. 1.6664-4(c) ALSO says that “reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.” So this puts the Palins in a tough spot.

Finally, Mr. Olsen has weighed in on the matter with his letter, available here: http://taxprof.typepad.com/taxprof_blog/files/palin_opinion_letter.pdf The main problem for the Palins in claiming reliance on this letter is that Mr. Olsen wrote it after they filed their returns. It might be sufficient for them to use for their 2008 returns, but I sure wouldn’t! I’ll discuss the letter next.

In sum, the Palins have two possible defenses to ward off imposition of the negligence penalty. First, they can say they had a reasonable basis for NOT reporting the \$43,000 and for deducting the \$9,000. Second, they can say that they reasonably relied on (a) the W-2, or (b) H&R Block, or (c) Mr. Olsen. None of those defenses really seem to help, but the H&R Block defense might work if there were more favorable facts than I have yet seen.

Did Mr. Olsen Do Something Wrong In Writing His Letter?

The last issue I will discuss is an interesting one raised by Mr. Olsen’s action in writing the letter he wrote.

Does Mr. Olsen's opinion letter for Governor Palin violate Circular 230, Section 10.35?

Circular 230 is the informal name for the regulations found at 31 C.F.R. section 10. It governs the practice of tax law before the IRS and sections 10.35 and 10.37 lay out the standards that tax professionals must adhere to when giving tax advice.

The stricter provision is 10.35, which kicks in when tax advice meets the definition of a "covered opinion." Advice which is a "covered opinion" needs to contain actual legal analysis, including citations to legal authorities that sustain the position taken. Section 10.37 governs advice documents that are not "covered opinions." It says "a practitioner must not give written advice ...concerning one or more Federal tax issues if the practitioner bases the written advice on unreasonable factual or legal assumptions..."

Mr. Olsen's letter appears to be a "covered opinion." A letter can be a covered opinion if "a significant purpose" of the letter "is the avoidance or evasion of any tax imposed by the Internal Revenue Code" and if it falls under one of the sub-categories of covered opinions.

10.35(b)(2)(i)(C). Here, Mr. Olsen's letter seems to fall within the sub-category of "reliance opinion." Section 10.35(b)(2)(i)(C)(1) says an opinion is a reliance opinion if it states its conclusions "at a confidence level of at least more likely than not." Mr. Olsen states his conclusions absolutely, with no qualifiers! For example, as to the correctness of excluding the payments for Gov. Palin's husband, the letter concludes "Such payments for family members traveling on state business would not properly be included as taxable income on Government Palin's federal tax returns." That appears to be more than a "more likely than not" statement.

Mr. Olsen's letter does not appear to be excluded from 10.35 by any of the exclusions under 10.35(b)(ii). The closest one I saw was 10.25(b)(ii)(C), but that would not appear applicable because the advice is not "prepared for and provided to a taxpayer, solely for the use by that taxpayer, after the taxpayer has filed a tax return...reflecting the tax benefits of the transaction." Indeed, the whole point of the letter is to provide the advice "To Whom It May Concern" which one might assume includes the IRS. Further, even it was "prepared for" the taxpayer here within the meaning of the exclusion, I would think that Mr. Olsen has "reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return...filed after the date on which the advice is provided to the taxpayer." If so, then the advice cannot fall within the exception in 10.35(b)(2)(ii)(C).

If the letter is subject to 10.35, I submit it fails miserably to comply with the standards of practice imposed by 10.35(c). The last paragraph, in particular, is just junk. Consider again Mr. Olsen's broad conclusion: "Such payments for family members traveling on state business would not properly be included as taxable income on Government Palin's federal tax returns." It neither identifies nor analyzes the relevant legal rules or the relevant facts, much less apply the law to the facts. It's just a bald assertion that the payments for husband and kids were excludable. So who died and made Mr. Olsen King? We are a nation of laws and you would think a lawyer would analyze the actual law, kinda like I've done in this paper. It might be my analysis is wrong. But that is the point of making an analysis --- transparency.

Frankly, even if 10.35 does not apply to the letter, I think the letter might violate even the very generous standards of 10.37. That is because Mr. Olsen does not discuss the law in any recognizable way in ANY part of the letter. He does not cite or discuss section 61. He does not cite or discuss any theory of why Palin can exclude the payments. Thus, he does not cite or discuss section 162 or section 132 or section 274, much less any of the regulations that explain and apply those statutes, much less any of the court cases that would be applicable to the Palin's case and could make the difference between winning and losing.

In sum, Mr. Olsen's letter may be a brilliant political ploy. But it is a sorry excuse for a legal opinion on the tax consequences of the travel allowance problems in the Palin's returns.