

# Taxation Law



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## President's Message

by Scott L. David

We are pleased to provide you with the latest edition of the WSBA Tax Section newsletter. This issue represents the return of the newsletter in response to section member requests for its resurrection. Special thanks to Jennifer Gellner for her efforts and initiative in getting this newsletter together.

In this edition, we present several articles of current interest to practitioners. In future issues, we plan to continue to publish timely and useful articles and to introduce features that will be useful to practitioners, including, for example, contact and calendar information and materials from the Internal Revenue Service and the Washington Department of Revenue.

This has been a challenging year for tax practitioners. On the federal side, in addition to the continuing change and evolution in the tax code and domestic and international tax issues, significant attention has been focused on Circular 230 and the evolving requirements that

are imposed on tax practitioners and their firms. In the area of Washington state tax practice, new initiatives of the Legislature and the DOR affect a broad range of practitioners. Trust and estate planners and employee benefits practitioners continue to deal with myriad challenges associated with integrating new laws and the often contradictory requirements of federal and state law in a challenging economic environment.

The Tax Section has continued to seek to provide support and services to its members to aid in meeting these challenges. In the past year, the section has organized and sponsored CLE and other educational opportunities. These include the periodic meetings of the State and Local Tax Section (which is headed by Bob Mahon) with officials of the DOR and the BTA and a very successful Circular 230 seminar. The section continues to support additional meetings of tax attorneys, including international and transactional tax practitioners. The section continues to explore opportunities to provide joint presentations with other groups, including the ABA and CPA societies. We

are interested in expanding the range of offerings and welcome suggestions of programs that may be of interest to practitioners.

The Tax Section continues to maintain active liaison relationships with other sections. This permits the section to coordinate on areas of interest to practitioners in various specialized areas.

Like many other WSBA sections, the Tax Section has seen a gradual reduction in its membership. The section recognizes that, in order to maintain interest in section membership, it must provide services to members and provide a voice to practitioners throughout the state. Toward this end, the section is exploring an expansion of its legislation review processes, newsletter features, and continuing attention to timely and useful CLE programs.

As I transition out of the position of president of the Tax Section, I want to give special thanks to the members of the Tax Section Executive Council for their diligence and continuing attention to members interests in the past year. Finally, and most importantly, thank you to all of the members for your continuing support of the Tax Section.

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## Planning for the Washington Estate Tax

by Benjamin G. Porter – Chair, Estate & Gift Tax Committee, Washington State Bar Tax Section

### The New Washington Estate Tax

The new Washington estate tax imposes a separate stand-alone estate tax on transfers of property located in Washington owned by persons dying after May 16, 2005. (RCW 83.100.04(1)) The Washington estate tax is imposed on the

decedent's "gross estate" as that term is defined for federal estate tax purposes in Section 2031 of the Internal Revenue Code (the "Code"). The deductions allowed against the federal gross estate by Chapter 11 of the Code for the federal estate taxes

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are also allowed against a decedent's gross estate for the Washington estate tax. However, the Washington estate tax disallows the deduction for state death taxes allowed for federal estate tax purposes under Code Section 2058.

The Washington estate tax is imposed on the "Washington taxable estate" (RCW 83.100.020(13)), defined as the federal taxable estate as adjusted, less \$1.5 million for people dying before January 1, 2006, or less \$2.0 million for people dying after January 1, 2006, and less a special deduction provided for farm and woodland properties under RCW 83.100.046.

The Washington estate tax is imposed at graduated rates from 14% to 19% for estates over \$9 million. Assuming the Washington estate tax may be deductible in determining the federal estate tax, the effective rate of the new tax is nearly 9% for the largest estates.

The Washington tax does not tax gifts and other lifetime transfers. However, the gross estate for federal estate tax as defined by Section 2031 of the Code brings back into the estate of a decedent a number of lifetime transfers (Code Sections 2036 – 2045). Those transfers are subject to Washington estate tax because the computation of the Washington taxable estate begins with all of the items included in the decedent's federal gross estate.

The Washington estate tax will not be affected by changes in the federal estate tax laws. For example the \$2 million Washington exemption effective this year will not change when, under current law, the federal exemption increases to \$3.5 million in 2009, when the federal estate tax goes away entirely in 2010, or when the federal estate tax returns with a \$1 million exemption.

### **When is Property Located in Washington?**

The estates of Washington residents are taxable on interests in tangible personal property and real property located in Washington and intangible assets regardless of the situs of the intangible assets. The estates of Washington non-residents are taxed on only interests in tangible personal property and real property located in Washington. Intangible property owned by non-residents is not subject to

the Washington tax. Examples of intangible property include stocks, bonds, interests in partnerships and limited liability companies, life insurance, annuities, bank accounts, business interests, retirement plans, and IRAs.

Washington Department of Revenue's Proposed Rules, WAC Chapter 458-57 (Estate and Transfer Tax) (the "Proposed Rules") suggest that a trust beneficiary's interest in a trust holding Washington real estate will be treated as Washington property. The proposed regulations do not, however, distinguish properties held in a revocable trust from properties held in an irrevocable trust. However, it is likely the interest of a grantor-beneficiary of a revocable trust will be taxed based on the nature and location of the underlying assets held by the trust. On the other hand, the interest of a beneficiary of an irrevocable trust would appear to be an intangible asset, regardless of the location or nature of the underlying assets.

### **Planning Strategies to Convert Taxable Washington Property to Nontaxable Property**

The different Washington tax treatment of tangible and intangible property presents planning opportunities to reduce the property subject to tax. For example, a Washington resident with an interest in out-of-state tangible personal property or real estate should hold that property in a way that it will be deemed property located outside Washington. Accordingly, those kinds of assets should be held outright, or in a revocable trust, as a tenant in common, or tenant with right of survivorship. On the other hand, a non-resident owning tangible personal property or real property located in Washington should hold the property in a way that it will be deemed intangible property not subject to Washington tax. Those assets should be held in a corporation, limited liability company, or partnership.

### **Effective Date and Potential Retroactive Application of the Tax**

Laws 2005, Chapter 516, § 20, provided: "This act [the Washington estate tax Act] applies prospectively only and not retroactively." However, the use of the Code definition of "gross estate" that in-

cludes lifetime transfers made prior to death (Code Sections 2035-2045) may result in prohibited retroactive application of the Washington estate tax to transfers made prior to May 17, 2005. For example, pursuant to Code Sections 2035 and 2042 the proceeds of a life insurance policy on the insured's life given away within three years of the insured's death is brought back as part of the insured's federal gross estate under Code Section 2031. The Proposed Rules take the position that all transfers included in the federal gross estate are subject to the Washington tax, whether made before or after the effective date of the Washington estate tax.

It would appear that if the Washington estate tax is imposed on a completed gift made prior to May 17, 2005, when Washington had neither a gift or estate tax, the tax would be inconsistent with Section 20 of the bill prohibiting retroactive application of the tax, as well as the Due Process and Impairment of Contracts clauses of the U.S. Constitution.

### **Avoiding the Washington Estate Tax by Making Outright Gifts**

The Washington estate tax is imposed on only a decedent's Washington property that is transferred at the time of death. Except for those pre-death transfers that are included in a decedent's federal gross estate under Code Section 2031, there is no Washington counterpart to the unified gift and estate tax rules found in the federal gift and estate tax laws. Outright gifts are simply free of Washington tax.

For planning purposes, consideration should be given to making large outright deathbed gifts. The gifted property should be property that has an income tax basis close to the value of the gift, so the loss of the federal estate tax step-up in basis will be unimportant. Although the gift would reduce the available unified credit upon the donor's death, the transfer would avoid the Washington estate tax.

### **Apportionment of the Washington Estate Tax Between Washington Property and Non-Washington Property**

Since the Washington estate tax is to be borne only on Washington property, a formula is provided in the statute that is

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## The Stouder Award

The Stouder Award is intended to recognize and honor outstanding service to the Taxation Section and the tax bar in Washington state. The award is not given annually, but is presented periodically when an individual who has devoted time to the advancement of the tax bar and tax practice in Washington state and is a role model or an exemplary tax practitioner comes to the attention of the section.

The Stouder Award was established in the spring of 1999 as a way to honor Roger Stouder's contribution to the tax bar. Roger Stouder was an exemplary tax practitioner; he served on the Tax Section's committees, and he actively contributed to the section. Prior year recipients of the award have all possessed the qualities that the Stouder Award is meant to recognize. Past recipients of the award include Jack Huston, Professor Meade Emory and Professor Ron Hjorth.

The selection of this year's recipient of the Stouder Award continues the tradition of recognizing those individuals who exemplify the very highest standards of tax practice.

The Stouder Award for 2006 is awarded to Bill Burkhart. Bill is a longtime tax practitioner with the Seattle law firm Preston Gates & Ellis LLP. His tax practice includes corporate, partnership and individual work at the state, local and international levels. His more than 35 years of experience in tax-related matters include his prior practice as a CPA for the accounting firm of Coopers & Lybrand and nine years with a New York City law firm.

Bill has quietly served clients for many years, and he is widely recognized as being an exceptionally creative and thorough tax practitioner. His work has established a very high standard of practice in the Seattle tax community. He has been responsible for the tax and business structuring of many of the largest corporate and infrastructure-related transactions to occur in the Northwest in the last 25 years. His high standards of professionalism, his dedication to both his practice and his colleagues both at Preston and in the broader tax community, and his expansive view of the tax code, together cause Bill Burkhart to be a very worthy recipient of this recognition.

## Pension Roundtable

The Pension Roundtable is a group of lawyers, actuaries and accountants who focus on the law of employee benefits. Tax law is the largest component of our focus, because employee benefits enjoy significant tax advantages. However, the group also focuses on other applicable law, especially federal labor law, that regulates or affects employee benefits. The group's activities are largely focused on self-education, although on occasion the group has recommended to the Tax Section revisions of state law that impact employee benefits, such as the exemption of certain retirement benefits from attachment or garnishment by creditors.

The group meets monthly. Anyone interested in more information about the Pension Roundtable should contact its chair, Richard A. Hopp, at (206) 386-7609 or rahopp@stoel.com.

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### *Planning for the Washington Estate Tax ... continued from previous page*

intended to apportion the tax between Washington property and property that is not Washington property (RCW 83.100.040(20)(b)). Unfortunately, the formula provided by the statute is flawed and will fail in many cases to properly apportion Washington estate tax.

The apportionment statute provides that the Washington estate tax is to be multiplied by a fraction, the numerator of which "is the value of the property located in Washington" and the denominator of which "is the value of the decedent's gross estate." Since RCW 83.100.20(5) defines "gross estate" as the gross estate used for federal estate tax purposes under Code Section 2031, the denominator is the decedent's worldwide gross estate, undiminished by available deductions.

Thus, for example, assume that a decedent owned assets with the same gross values in both Washington and outside Washington. Since the gross values would be equal, using the fraction provided in the statute, one-half of the tax would be apportioned to the Washington property and one-half to the property outside Washington. However, since the Washington estate tax is computed on the net federal taxable estate, the use of the gross estate value in the allocation fraction, rather than the net taxable value, will result in an allocation that has no relationship to the relative net values of the properties within and outside Washington.

A second problem with the allocation formula is that the deduction for qualified farm and woodland property does not require the property be located in Washing-

ton. The allocation formula excludes the deduction for farm and woodland properties from both the numerator and denominator of the fraction. If the qualified farm and woodland property is located only in Washington, the formula will result in a larger allocation of the tax to out of state property. The opposite result will occur if the farm and woodland property is located outside Washington.

To the extent that the allocation fraction results in tax being assessed against property outside Washington, there is a question whether the full Washington estate tax will be eligible for a deduction for federal estate tax under Code Section 2058 as a state death tax. Cf. Rev. Rul. 52-230, 1956-2 C.B. 600, which denied a credit for state taxes under similar circumstances.

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## Recent Cases

### Tax Court Lacks Jurisdiction to Determine Relief in Underpayment-only Stand-alone Case

In *Commissioner v. Ewing*, 439 F.3d 1009 (9<sup>th</sup> Cir. 2006), the United States Court of Appeals for the Ninth Circuit held that the Tax Court does not have jurisdiction under Internal Revenue Code (“I.R.C.”) section 6015(e) to determine relief under I.R.C. section 6015(f) when there is no deficiency. Internal Revenue Code section 6015(e) sets forth the requirements for a petition for review by the Tax Court in I.R.C. section 6015 cases. The Ninth Circuit agreed with the Internal Revenue Service that, under the plain reading of I.R.C. section 6015(e), the Tax Court has jurisdiction over a petition only when a deficiency has been asserted. Consequently, the Ninth Circuit reversed the Tax Court’s decision in *Ewing v. Commissioner*, 118 T.C. 494 (2002), in which the Tax Court held that it had jurisdiction to review the Service’s denial of relief under I.R.C. section 6015(f) for an underpayment of tax shown on the joint return with respect to which the Internal Revenue Service had not previously issued a notice of deficiency.

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### Website Committee News

The website committee is responsible for acting as a liaison between the WSBA Tax Section webmaster and members of the Tax Section. Committee meetings and events are posted on the Tax Section’s website, as well as information pertaining to Continuing Legal Education Courses and this newsletter. The website committee welcomes the submission of articles for publication on the Tax Section’s website, in addition to hyperlink suggestions to helpful tax topics. Please visit [www.wsbatax.org](http://www.wsbatax.org) for more information.

### Court Limited to Administrative Record in Collection Due Process Review

In *Robinette v. Commissioner*, 439 F.3d 455 (8<sup>th</sup> Cir. 2006), the Eighth Circuit Court of Appeals, reversing the Tax Court, agreed with the government that judicial review of a collection due process determination should be limited to the record developed during the administrative hearing process. The Eighth Circuit held that the Tax Court had erred in holding that the Administrative Procedure Act did not apply to its judicial review and could therefore consider evidence outside the administrative record when reviewing for abuse of discretion under Internal Revenue Code section 6330.

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### Scholarship Committee News

The WSBA Tax Section annually awards a scholarship to a graduating student from a Washington law school who has been accepted by and plans to attend a tax LLM program at a U.S. law school in the Fall of that same year. The scholarship is awarded based upon: (1) the likelihood that the applicant will become an active member of the Washington State Bar Association and will focus his/her practice in tax; (2) the applicant’s financial need for the scholarship; and (3) the applicant’s scholastic achievement. The Tax Section is currently in the process of raising funds for the scholarship. Formal requests for contributions were sent out at the end of March 2006. The Tax Section hopes to raise \$5,000 for the scholarship. The recipient of the scholarship will be announced at the Tax Section’s annual luncheon in May 2006. If you are interested in making a contribution to the scholarship, please email Nicole Chicoine at [nicocle@chicoine-hallett.com](mailto:nicocle@chicoine-hallett.com).

### Collection Due Process Testimony Excluded on Relevancy Grounds

The Tax Court held that evidence not in the administrative record of a collection due-process case is not admissible at trial if it is not relevant to the question of whether appeals abused its discretion. The court accordingly held that respondent’s settlement officer did not abuse her discretion in rejecting petitioner’s offer-in-compromise and determining that respondent may levy to collect petitioner’s unpaid 1999 income tax liability. *Murphy v. Commissioner*, 125 T.C. No. 15 (Dec. 29, 2005).

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### Continuing Legal Education (CLE) Committee

The purpose of the CLE Committee is to work with the WSBA’s CLE Department to develop educational programming relevant to the diverse practices of the members of the Taxation Section. In February 2006, the Taxation Section co-sponsored a seminar with the Washington Society of Certified Public Accountants (WSCPAs) regarding recent amendments to the regulations governing practice before the Internal Revenue Service, otherwise known as Treasury Department Circular 230. The seminar featured Cono Namaroto, the then-director of the IRS Office of Professional Responsibility, as the keynote speaker and also included a question-and-answer session and panel discussion of emerging issues relating to Circular 230. The seminar was very informative and well received by the 100-plus tax practitioners who were able to attend, and we look forward to developing and sponsoring similar programming in the future.

The Taxation Section is currently in search of candidates to replace the outgoing chair, David Petteys. Interested candidates should contact David at [dpetteys@perkinscoie.com](mailto:dpetteys@perkinscoie.com) or (206) 359-3981.

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## Federal Tax Liaison Committee

The Federal Tax Liaison Committee is your resource for communicating with the Internal Revenue Service about specific or systemic issues you may have with the Service, generally on procedural matters. The chair attends quarterly liaison meetings hosted by the IRS at which representatives of the various sections of the IRS are available to answer questions or take complaints. The meetings are also attended by representatives from a number of other tax practitioner groups, and the IRS is generally very responsive to the issues raised. All Tax Section members should feel free to contact the chair with issues they would like raised at these liaison meetings.

The chair also may attend the annual Western Region Liaison meeting during which IRS regional managers address issues raised by representatives from the bar associations of a number of western states. Again, Tax Section members should feel free to contact the chair with any issues or concerns they would like discussed at these regional meetings.

Various communications from the IRS and other relevant items are posted on the Federal Tax Liaison's page of the Tax Section's website. Should there be sufficient interest, the chair may arrange periodic brown-bag meetings for IRS employees or other federal tax specialists to make a short presentation on relevant issues.

## International Tax Committee

by Chris Brown – Garvey Schuber Barer

Look around and you will see that very few tax attorneys have a completely domestic practice anymore. Perhaps you have a client that is setting up an office in China. Or a client that has decided to outsource activities to India. Maybe you've set up a U.S. partnership and suddenly discovered there will be a new foreign partner. Or your favorite start-up client has issued stock options to a foreign R&D team. Perhaps a colleague in the real estate practice wants advice on the FIRPTA rules, or an immigration attorney has a client who just won the lottery and suddenly likes the idea of returning home. The fact is, just about everyone has to deal with the tax issues of cross-border migrations, whether in the form of business transactions or the movement of people or wealth across borders.

We want to explore these issues and more in the International Tax Committee. As part of our *International Tax Roundtable* series, we frequently co-sponsor lunchtime events with the International Tax Committee of the Washington Society of Certified Public Accountants. At these events, you'll be able to hear speakers discussing emerging tax issues and have a chance to pose questions and debate any issues that arise. Past lunch-time

events have included talks on the new transfer pricing service regulations, Canadian tax issues, export incentives under Section 199, and perspectives from tax executives working for major corporations. By teaming with the WSCPA, we are able to organize events that draw a nice cross section of attorneys and accountants. This gives our participants a chance to make connections and to hear various perspectives on new tax issues.

In terms of future events, we're always looking for new ideas and new speakers. We would love to organize an event or two dealing with cross-border compensation issues. We would also enjoy hearing from anyone with practical experience in dealing with international tax audits, including transfer pricing issues. Of course, changes in the tax laws (including new cases and rulings) are another great source for ideas. Thus, if you have an interest in speaking or developing a topic, we encourage you to contact us and we'll help organize the event. We'll take care of the venue and sending out notice. Participating in *Roundtable* events is an ideal way to sharpen your delivery skills and make new contacts in the tax community.

I look forward to hearing from more of you. Stay tuned for more *International Tax Roundtable* events in the remainder of 2006.

**When you have finished reading this newsletter, please pass it on to someone else in your firm.**

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## Legislative Committee

The charge of the Legislative Committee is to review tax-related legislation referred to the Section by the WSBA Legislative Department and identify bills affecting the practice of taxation law. Under the Bylaws of the WSBA, the Bar and its sections and committees are not permitted to take legislative positions on political or social issues that do not relate to or affect the practice of law or the administration of justice. As such, the Taxation Section refrains from taking an official position with respect to, or otherwise attempting to influence, the formulation or execution of tax policy, and instead generally limits its

participation in the legislative process to procedural, technical, or constitutional issues involving tax bills.

Each legislative session produces literally hundreds of tax-related bills in a very short time frame, and attempting to review and keep track of all that legislation is a daunting task. Consequently, the Taxation Section would like to encourage members to join the committee and get involved in bill tracking. Interested members should contact the chair of the committee, David Petteys, at [dpetteys@perkinscoie.com](mailto:dpetteys@perkinscoie.com) or (206) 359-3981.

## CLE Credits for Pro Bono Work?

## Limited License to Practice with No MCLE Requirements?

Yes, it's possible!

Regulation 103(g) of the Washington State Board of Continuing Legal Education allows WSBA members to earn up to six (6) hours of credit annually for providing pro bono direct representation under the auspices of a qualified legal services provider.

APR 8(e) creates a limited license status of Emeritus for attorneys otherwise retired from the practice of law, to practice pro bono legal services through a qualified legal services organization.

For further information contact Sharlene Steele, WSBA Access to Justice Liaison, at 206-727-8262 or [sharlene@wsba.org](mailto:sharlene@wsba.org).

## Information for Your Clients

Did you know that easy-to-understand pamphlets on a wide variety of legal topics are available from the WSBA? For a very low cost, you can provide your clients with helpful information. Pamphlets cover a wide range of topics:

- Alternatives to Court
- Bankruptcy
- Communicating with Your Lawyer
- Consulting a Lawyer
- Criminal Law
- Dissolution of Marriage (Divorce)
- Elder Law
- Landlord/Tenant
- Lawyers' Fund for Client Protection
- Legal Fees
- Marriage
- The Parenting Act
- Probate
- Real Estate
- Revocable Living Trust
- Signing Documents
- Trusts
- Wills

Each topic is sold separately. Pamphlets are \$9 for 25, \$15 for 50, \$20 for 75, and \$25 for 100. Pricing for larger quantities is available on request.

To place your order or for more information, please contact the WSBA Service Center at 800-945-WSBA or 206-443-WSBA. Sales tax is applicable to all in-state orders.



## Speak Out!

Wanted: Lawyers to volunteer to speak to schools and community groups on a variety of topics.

For more information about the WSBA Speakers Bureau, contact Dené Canter at 206-727-8213 or [denec@wsba.org](mailto:denec@wsba.org).

## Service Center... at your service!

800-945-WSBA or 206-443-WSBA  
[questions@wsba.org](mailto:questions@wsba.org)

We're here to serve you! The mission of the WSBA Service Center is to respond promptly to questions and requests for information from our members and the public.

Call us Monday through Friday, from 8:00 a.m. to 5:00 p.m., or e-mail us at [questions@wsba.org](mailto:questions@wsba.org).

Assistance is only a phone call or an e-mail away.

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The Taxation Law newsletter invited its readers to submit articles, items of interest, and announcements for publication in upcoming issues. Share your expertise, your knowledge, and your insights for the benefit of your colleagues.

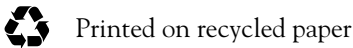
So you have an idea you would like to flesh out, or a finished article ready to go?

Please contact the Officers of the Tax Section by sending an e-mail from the Taxation Section web site at the following link: <http://wsbatax.tripod.com/officers/roster.htm>.

We would like to read what you have to say.

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## Please Donate to the Tax Fund Scholarship

We will soon be soliciting contributions to the Annual Tax Section Scholarship Fund. The scholarship will be awarded to a graduating student from a Washington state law school who has been accepted by, and plans to attend a tax LL.M. program at a U.S. law school during the 2006-2007 academic year.

Through the generosity of the Tax Section members, the section has been able to assist LL.M. students with their program

tuition. Please remember the Tax Section Scholarship as you prepare your next year's budgets.

In past years the amount of the scholarship has been approximately \$5,000. Members of the Tax Council of the Tax Section will award the scholarship based on several factors, including the likelihood an applicant will become an active member of the Washington State tax bar.

### Taxation Law Section Membership Form

*Section membership dues cover October 1, 2005 to September 30, 2006.*

Please enroll me as an active member of the Taxation Law Section. My \$30 annual dues are enclosed.

I am not a member of the Washington State Bar, but I want to receive your Newsletter. My \$30 is enclosed.

Name \_\_\_\_\_

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