POINT & COUNTERPOINT

To Repeal or Retain Section 1031: A Tempest in a $6 Billion Teapot

By Bradley T. Borden, Joseph B. Darby III, Charlene D. Luke & Roberta F. Mann*

This article is a condensation and summary of the “Lincoln–Douglas Debate on Whether to Repeal Code § 1031” held at the Teaching Tax Committee meeting at the 2015 ABA Section of Taxation Midyear Meeting in Houston, Texas. The debate itself was lively and fun, and raised numerous interesting and provocative points on both sides of the issue. The authors thank Stephen Breitstone for filling in at the last minute to participate in the debate. The arguments for and against repeal are presented in article format here, but the authors are not in full agreement with respect to each argument.

To retain, repeal, or reform? These are the questions section 1031 invites. This brief article attempts to lay out the competing arguments in favor of each of the first two questions and then explores the two most prominent reform alternatives. If each of the four authors were to have individually stated their views as to each question, readers would be faced with twelve essays. Instead, they have combined and condensed their argument into four parts: (1) a short history of section 1031; (2) the arguments in favor of repeal; (3) the arguments against repeal; and (4) potential avenues for reform.

Short History of Section 1031

The first “modern” income tax law was adopted by Congress in 1913, and the first antecedent to section 1031 was enacted eight years later, in 1921. The original provision was broader in scope than present-day section 1031, providing that no gain or loss would be recognized on an exchange of property if: (1) the property received did not have a readily realizable market value or (2) the property transferred was held for investment or for productive use in a trade or business and exchanged for property of a like kind or use. The provision allowing non-like-kind exchanges of property was soon eliminated in 1924, and since then the like-kind exchange rules have remained substantially intact, with the legislative tweaks described below, for almost 100 years.

The law itself was substantially unchanged from 1924 to 1984, but during that period a significant body of section 1031 case law developed. Perhaps most importantly, the courts fleshed out the parameters of the section 1031 exchange requirement. They held that multiple-party transactions could satisfy the statutory requirement only if the exchanger was not in actual or constructive receipt of the exchange proceeds. Consequently, most multiple-party exchanges required a facilitator.

In response to the Ninth Circuit’s 1979 holding in Starker v. United States that a transaction qualified as an “exchange” even though there was a two-year gap between the transfer of the relinquished property and the receipt of the replacement property,
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FROM THE CHAIR

Giving Back to the Tax System

By Armando Gomez*

As tax professionals, members of the Tax Section derive our livelihood from the tax system. There are many ways in which we can all give back to the tax system that supports us. This is not just the right thing to do, but under the Model Rules of Professional Conduct, each of us has a professional responsibility to provide legal services to those unable to pay. Rule 6.1 encourages lawyers to perform at least 50 hours of pro bono services each year, and suggests a number of ways in which lawyers can meet this aspirational goal. This column illustrates how those suggestions might be applied by members of the Tax Section. I also encourage you to read the remarks of the Section’s 2015 Janet R. Spragens Pro Bono Award recipient Keith Fogg and the article by Wells Hall on the Section’s Military Adopt-A-Base program in this issue of the NewsQuarterly.

Representation of the Underserved

The Model Rules encourage lawyers to devote a substantial majority of their pro bono hours each year to providing services to persons of limited means, or to charitable or governmental organizations in matters that are designed primarily to address the needs of persons of limited means. Members of the Tax Section regularly devote their time and talent to assist low-income taxpayers in tax controversies. For example, through the Tax Court calendar call program, lawyers can assist pro se taxpayers, most of whom do not understand the Tax Court procedures and often do not have a firm grasp on the tax law requirements necessary to support the claims made in their Tax Court petition. Even if you have never represented a taxpayer in Tax Court before, most tax lawyers will have a better grasp of the rules than pro se taxpayers. And through the dedication of Tax Section members throughout the country, there is a network of experienced lawyers who can provide training and guidance to those interested in helping pro se taxpayers through this program.

Of course, tax controversy work is not for everyone, but there are plenty of other opportunities for Tax Section members to meet their pro bono obligations. Each year a number of our members help low-income taxpayers prepare their tax returns through the Volunteer Income Tax Assistance (VITA) program. There are two ways that you can participate in VITA. First, you can become certified as a VITA volunteer, and help prepare returns for low-income taxpayers at designated VITA sites. Through an agreement that the Tax Section reached with the Service, our members can become certified on-line, without having to attend classroom instruction on basic tax topics. As a volunteer, you will then help low-income taxpayers meet their annual tax compliance obligations. Second, you can become a VITA instructor, and through the Tax Section’s Adopt-A-Base program, you can help train members of the military on how to prepare returns through the VITA program.

For a number of our members, pro bono presents an opportunity to provide legal services outside of the tax arena. Many law firms and local bar associations have referral

aba model rules of professional conduct

rule 6.1: voluntary pro bono publico service

Every lawyer has a professional responsibility to provide legal services to those unable to pay. A lawyer should aspire to render at least (50) hours of pro bono publico legal services per year. In fulfilling this responsibility, the lawyer should:

(a) provide a substantial majority of the (50) hours of legal services without fee or expectation of fee to:

(1) persons of limited means or

(2) charitable, religious, civic, community, governmental and educational organizations in matters that are designed primarily to address the needs of persons of limited means; and

(b) provide any additional services through:

(1) delivery of legal services at no fee or substantially reduced fee to individuals, groups or organizations seeking to secure or protect civil rights, civil liberties or public rights, or charitable, religious, civic, community, governmental and educational organizations in matters in furtherance of their organizational purposes, where the payment of standard legal fees would significantly deplete the organization’s economic resources or would be otherwise inappropriate;

(2) delivery of legal services at a substantially reduced fee to persons of limited means; or

(3) participation in activities for improving the law, the legal system or the legal profession.

In addition, a lawyer should voluntarily contribute financial support to organizations that provide legal services to persons of limited means.

* Skadden, Arps, Slate, Meagher & Flom LLP, Washington, DC.
Dr. Jane G. Gravelle

In our 1999 interview we did not talk about the taxation of foreign income, and yet today it seems to be the centerpiece of many proposals for major tax changes. How are proposals in the foreign area likely to fit into larger tax legislation and how important do you think it is to make dramatic changes in the taxation of foreign business income?

I would say the system we have now is very imperfect, and also there ought to be a way to improve on it. Right now we have deferral and also these new companies with intangible assets apparently have been shifting a lot of their profits abroad and leaving them there. So there is this huge accumulated unrepatriated income that we have not taxed. I do not really think there is a big distortion in investment from what we have now, so it may not be that important whether we go to a system that currently taxes worldwide income or to a territorial system or something in between, like a lower tax on foreign source income. Most countries where business makes real physical investments have effective tax rates that are marginally similar to ours. I actually calculated some of those in a paper I wrote on international tax rate comparisons.

I think the real issue that is going on now with the taxation of foreign source income is that there is a lot of profit shifting going on. My report on tax havens showed the growth between 2004 and 2010 in the multinational profits in tax havens where holding companies are located (such as the Netherlands) and the growth is astonishing. When I looked in 2004, the Cayman Islands had multinational profits that were about 650% of Cayman Island GDP. Now it is over 2000%. So there has been a huge increase in the revenue estimates of deferral by the Treasury Department and by the Joint Committee on Taxation. As a result, I think income shifting is what now affects tax revenues more than shifts in real economic activity.

But the biggest tax expenditure in the foreign area right now is deferral. So if you were to eliminate deferral you would raise a lot of revenue which you could use for rate reduction, but there are a lot of companies opposed to that. I think the repatriation problem is less serious than a lot of people say it is. In fact there is a theory that says repatriation taxes and dividends really do not matter, that foreign income is kind of trapped abroad already one way or the other. But we could do some compromise—apply a lower rate to foreign income and get less revenue that way. If you go to a territorial tax system, you really are going to need some strong effective anti-abuse rules or it will make profit shifting even worse.

I think we could improve on the current system, but the choice of which way we go depends on a lot of factors. I mean if you were just standing aside and looking at maximizing U.S. welfare, you would say end deferral, tighten up on inversions, and collect that revenue. But, I am not sure that is the outcome that we are going to see. As I said, you can get rid of repatriation taxes by ending deferral, by moving to a territorial tax, or doing anything in between, such as a lower tax rate plus a requirement that you repatriate a certain portion of foreign income. There are a lot of ways to do an intermediate system.
Q You have previously identified the 1970s as an era when a different kind of organized business interest group tax lobbying appeared, and it grew in following decades. Has tax lobbying changed since we last talked?

A I think if anything business lobbying for tax benefits has gotten worse. I mean, the impression I get here on Capitol Hill is that the large firms like Apple and Google are heavily lobbying in the international area because they want to be able to bring their profits back without paying taxes or paying as much tax. A recent example is the issue of the medical device tax. It is a tiny little tax, probably relatively unimportant. According to research I have done, it has very little effect on jobs simply because demand for medical devices is very inelastic—you are not going to give up your pacemaker because the price goes up 2%, or 2.3%. Yet there is this very heavy lobbying effect by these large medical device makers that is elevating this little tax of minor importance into a major one—one that was part of the bargaining chips when the government was closed in 2013.

So if anything, I think tax lobbying has gotten worse. It is very hard for members of Congress to really hear an analysis that is not somebody looking for their own private interest.

Q Does the CRS self-identify provisions to study in this regard or must the studies be requested? To the extent it selects its own subjects for study, how is that done?

A When I decide to do papers as opposed to responding to requests, I just look at what Congress is talking about. So that is why I wrote something on dynamic scoring and that is why I write a lot on international tax issues. How other people decide, I do not know, but that is how I decide. I try to write papers that are about the issues before Congress, which is my obligation here.

Q You previously predicted that a value added tax would be hard to enact and since then the interest in a VAT or “flat tax” seems to have abated. But at some point does not the classic income tax reform formula of broadening the base and lowering the rates approach a sort of consumption tax?

A Well, that is not actually where we are heading right now. Basically the corporate rate reductions that were in the Camp proposal or the discussion papers that Baucus’ Senate Finance Committee put out are all trying to broaden the base to pay for a corporate rate reduction. The only pressure I see moving towards a consumption tax base, and it has yet to be determined where we go, is bonus depreciation. So bonus depreciation was enacted in 2008. It was supposed to be a short term stimulus, but somehow it got in with the extenders and it keeps being extended. It would tend towards a consumption base, but it is a big revenue loser if you make it permanent. In general the tax reform efforts that I have seen remain squarely within the income tax framework.

If there is a flatter income tax rate structure, in order to move in the direction of a consumption tax you would still need expensing of investments. We are talking about the opposite, slowing depreciation, and in the Camp bill capitalizing advertising and R&D. So that is really not moving towards a consumption tax.

Q In our 1999 interview you mentioned the problem of accommodating to a price adjustment if a VAT were adopted and cited a possible 12% fall in GDP after enactment of a VAT. However, this problem does not seem to be much discussed. Is the explanation that proponents of income tax cuts (and possibly consumption tax increases) are not so concerned about the “demand side” as they are about the “supply side”? Does supply side economics as such still have supporters?

A Well, certainly supply side economics has lots of supporters. I do not know why people ignore this very crucial aspect of enacting a significant VAT, whether the VAT replaces the income tax or is added to raise a lot of revenue. The VAT would have macroeconomic effects on the economy either in pushing up inflation or pushing down output. My guess is that if we really got to the point where it looked like something was going to happen, the macroeconomists would notice and say something. It is just we have not gotten that far. Up to now the VAT has mostly been an academic issue, and so far the academics do not pay much attention to the effects on demand, maybe because they are tax people rather than macroeconomists. I do not have a good answer to that. I still think that is a crucial issue with moving to a value added tax.

Q Most proponents of decreasing the income tax on capital say that it would increase “savings and investment.” Are those two different things? Perhaps taxing consumption would encourage people to save, and perhaps flooding banks with savings might lower some interest rates and entice businesses to borrow and invest in plant and equipment; but we have low interest rates right now and such investment is not occurring (or maybe not fast enough). So what is the relationship between savings and investment?

A Well, certainly savings and investment would be the same in the long run in a closed economy, but not in an open economy where some of your savings can flow abroad and some of your investment can come from abroad.

I think what we are seeing right now, or have been seeing, is not a long run effect, but the effect of reduced demand on investment. If you have reduced demand and you have excess capital, even very low interest rates are not going to induce you to spend. I think that is
really a consequence of the fairly serious recession that we just went through.

In the long run, I also am not sure about savings response to tax rates because it is hard to really get good evidence, but we have not seen the kinds of changes in savings rates when we cut taxes or when the interest rates rise that we would expect to. It is maybe just that people do not respond to rates of return, maybe they have targets for saving, so that is a very uncertain area. You can have an increase in investment by cutting corporate taxes, but even those results are small. There is a small response to corporate tax rates because capital flows from abroad are limited because of investors’ preferences and also the constraints of the production function that limit how much capital you can absorb without pushing down the rate of return enough to end additional flows.

In 1999 you predicted that the then recent capital gains rate reduction would lose more revenue than planned. Since then we have had further reductions and have extended the capital gains rate to dividends. Did those reductions lose more revenue than predicted?

I really have not looked closely at capital gains since then and you cannot always tell just by looking at a time series how much revenue has changed. I still do not think that the realization elasticity is very high. I think it is low, so I really think when you cut the capital gains tax you lost revenue, definitely you lost it with the reduced taxation of dividends, which do not have that kind of realizations response. So I think those preferences lost revenue.

“Tax reform” is popular again. Does “tax reform” have an objective meaning or is it just the term we like to apply to the tax change we like today?

Well, I guess I am more inclined to say that latter—that tax reform is defined very differently by very different people. I think economists would say tax reform is something that increases at least one of the goals of taxation without making others a lot worse: efficiency, that is eliminating distortions in the tax system, equity and fairness, at least maintaining the current distribution, and simplicity. Simplicity is sort of always there and often not paid much attention to. So that is how I would define a reform as opposed to just a change. You can have changes that worsen things.

Is there anything that you are currently working on that you can talk about and that you would like to comment on?

Well, I do think the claims for big economic growth effects, or even big efficiency effects from tax reform, need to be considered very carefully. When the Joint Committee estimated the Camp bill, they used two models. One of the models they used was called an overlapping generations model. It is a model where individuals optimize over their lifetimes. They have perfect foreknowledge, perfect information, and they behave perfectly rationally. I doubt how well the model works to explain savings.

But they also added onto this a model that JCT obtained from John Diamond and George Zodrow at the Baker Institute at Rice University. That model introduces something very strange related to the Camp proposal that would impose lower tax rates on intangible investments which shift the ownership of intellectual property out of tax havens into the United States. There is some doubt about how much effect that might have since a zero rate is better than anything. But even if a tax change did prevent sending IP offshore, it would not change anything real. I mean, if you moved the rights to sell advertising for Google from Ireland back to the United States, that is not going to change anything Google does. If you move the area of the patents where Lipitor is held, that is not going to change how people make pills. They are not going to suddenly lose the formula. Or Apple is not going to lose access to technology for items made in Singapore or China because the patent is moved back to the United States. That does not make any sense. And yet, it was treated in this modeling as a type of capital that can be moved back to the United States.

That proposal is responsible for a good piece of the large effect on output that was found for the Camp bill. The Joint Committee’s estimates found an increase in GDP for their own in-house model of 0.2% or 0.1% over the ten years. This other model found 1.5%. There are a lot of reasons things like that happen, but a significant piece of that, probably over a half of the difference between this model and the other one, is due to this treatment of intangibles which just does not make any sense to me. Apparently it does not make sense to other people. William McBride at the Tax Foundation made the same set of comments about that. So, we do have to be careful in revenue estimating to make sure that ideas are vetted and have gotten general approval and is not just some kind of new idea that has really been largely untested. I think the JCT has good people, and I think their job, which is very hard, has been made much harder. They are going to have to work hard at things like that and say just what is in a range of estimates. We have to decide what we think is a legitimate way to estimate these effects.

Which government organization makes “official” revenue estimates of tax proposals?

Officially it is only the Joint Committee on Taxation. That is what only they do. I can comment on it, I can talk about it, but I am not responsible for it. Only they are responsible for it. The Treasury has not done anything like dynamic scoring recently, and they do not really have a role in scoring. I am sure the Treasury analysts and the JCT analysts talk to each other, but it is basically just the Joint Committee on Taxation that would determine all of that.
Q Is there anything else you would like to add?
A We really need to look at these extender, including things like bonus depreciation, and make a final decision. When you have had something like the R&D credit that has been extended over and over again since 1981, it is time to say we have experimented with this enough to see if we want to keep it. I do think uncertainty in tax law is not good for taxpayers, so we should probably, maybe in the context of tax reform, make some decisions about that. I think we also may need legislation to deal with inversions regardless of what kind of tax reform we have because I do not think lowering the rate is enough. Going to 25% is not going to make you think zero does not look so good anymore. So those are the issues I think we are going to have to face—extenders and inversions.

DR. JANE G. GRAVELLE
INTERVIEW

Boxscore

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**PRO BONO MATTERS**

**Acceptance of the Janet R. Spragens Pro Bono Award**

By T. Keith Fogg*

**Introductory Note:** This year, the Section has the honor of bestowing the Janet R. Spragens Pro Bono Award on an individual who has had a profound impact on the pro bono community, as well as on his own pro bono clients. Professor T. Keith Fogg is the Director of the Federal Tax Clinic at Villanova University School of Law. In this role, he “touches” every case that comes into the clinic, giving assistance to pro se petitioners and training and mentoring future generations of pro bono attorneys. In the words of three of his nominators, “it would be easy for him to remain in the shelter of his academic post, but he does not. Rather, he spots injustices in tax policy and procedure and advocates for systemic change.”

Keith is active in the Tax Section and the LITC community and serves as Editor-in-Chief of the Section’s two-volume *Effectively Representing Your Client Before the IRS*, which many low-income taxpayer clinics and private practitioners rely on to help resolve their clients’ tax disputes. In addition, Keith finds time to write and publish articles and regularly contribute to the blog, Procedurally Taxing, which he co-founded. Keith currently serves on the Tax Section Council and is a past chair of the Section’s Pro Bono and Tax Clinics Committee.

For those of us who attended the Section’s 2015 Midyear Meeting in Houston, Keith’s remarks upon receiving the Pro Bono Award inspired and challenged us to think differently about serving low-income taxpayers. He has graciously allowed us to publish his remarks in this issue of the *NewsQuarterly.* –Katherine E. David, Chair, Pro Bono Award Committee

Thank you very much for this honor. I am humbled to follow in the footsteps of so many outstanding prior recipients of this award. I want to spend a few moments thanking some of the people who helped me get to a place where I could provide effective pro bono service to others, and then I want to ask two things of you so we as members of the tax bar can better serve the needs of the unrepresented.

I was very fortunate to have a mom who was deeply involved in volunteering in the less well-to-do neighborhoods of Richmond, Virginia. Throughout my childhood she dragged me along as she pursued her volunteer work. From her I learned both the value of volunteering to assist others and how very privileged I was to live in a comfortable suburb with wonderful, supporting parents.

I was very fortunate to get hired by the Service’s Office of Chief Counsel when I graduated from law school. Working there, I had the good fortune to work in an environment in which my office and my client sought to do the right thing and to find the right answer. Doing the right thing and finding the right answer is not always easy and becomes especially challenging in an adversarial system in which the other party is unrepresented.

I was very fortunate in 1992 when I was the District Counsel in Richmond, Virginia, to receive a cold call one day from a new law graduate who had an idea about starting a tax clinic in Richmond. She had worked as a tax professional for a number of years before going to law school. Upon graduation she found it difficult to find opportunities for pro bono service to taxpayers. Her idea was to start a nonacademic tax clinic, something which had never been done up to that point, through which tax professionals could use their expertise to assist taxpayers who would otherwise be unable to pay for representation. We spoke for about an hour, and her passion for the project was unmistakable. I encouraged her to pursue the idea, not knowing how much I would learn as Nina Olson founded and developed the Community Tax Law Project to serve the same taxpayers with whom my office worked.

I was very fortunate in 2007 to get hired by Villanova Law School to direct the tax clinic there. Villanova hired me despite the fact I had never seen or set foot in an academic clinic or written a scholarly paper.

I was very fortunate at Villanova to follow Les Book, another Janet Spragens Award recipient, who mentored me. He helped me to learn how to teach a clinic, how to produce scholarly research, and how to get involved helping low-income taxpayers in the greater community.

I was very fortunate as a faculty member at Villanova to become a member of the ABA through their group membership. Although I had attended Tax Section meetings several times as a speaker during my career with Chief Counsel’s office, I had not joined the ABA because of financial reasons. Villanova not only provided the membership but also the support to attend meetings and become involved.

I was very fortunate at a Section meeting shortly after I joined the Villanova faculty to meet Joe Schimmel. Joe, another Janet Spragens Award recipient and then the chair of the Low Income Taxpayers Committee, got me involved in the work of the committee literally within minutes of my asking and soon brought me into committee leadership.

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* Professor of Law and Director of Federal Tax Clinic, Villanova University School of Law, Villanova, PA.
I was very fortunate to work on the committee with other great leaders in the low-income taxpayer community—Kathryn Sedo, George Willis, and Susan Morgenstern—who taught me and assisted me in my work with the Tax Section and with other clinicians and taxpayers.

Those I have named and many others assisted me in my journey and helped me to live a very privileged life. They helped me to help others, and I wish to thank every one of them for their assistance over the years.

Since joining the low-income taxpayer community, I have observed how difficult it is for many of the clinicians in that community to effectively serve their clients. They are hindered by many impediments. (I wrote about this in some detail in an article published in the management journal for legal services, Keith Fogg, Tax Issues Facing Clients of Legal Services, Volume XXVIII, No. 1, at 17 (2014).) One of the biggest impediments is that most nonacademic clinicians are the only tax person in their office. They have no one in the office to mentor them as they try to learn the complexities of tax law. Frequently, tax clinicians do not have a significant background in tax law before being handed the job of running the clinic. In some instances they get assigned to the task because someone else leaves. Previously, tax clinicians may have practiced consumer law, housing law, or immigration law. Suddenly, they are called on to be tax lawyers, too, with no one in the office to guide their development.

Additionally, most nonacademic low-income taxpayer clinics do not have good research resources. They do not have access to Lexis, Westlaw, or Checkpoint. Rather, they must perform their research using Google and Cornell Law and other similar free sites. This makes a difficult situation worse. Because of this, the book published by the Tax Section, Effectively Representing Your Client Before the IRS, and provided at no cost to every tax clinic, becomes an even more valuable resource than might be imagined. I have worked to edit and write in this publication because of its importance in guiding the clinicians who greatly need this assistance.

The focus of my pro bono efforts has been on assisting clinicians so that they can more effectively assist their clients. I was fortunate to come to the tax clinic world with decades of tax experience that most of them lack.

With this background in mind, I make two requests of you. First, I ask that you get to know the clinicians in your community. Take them to lunch. Even though you may not know low-income tax issues, you know tax and how the tax system works. Your guidance and assistance to the clinicians could greatly assist them in learning and becoming more effective. You can also assist in integrating them into the tax practice community in your area. (Look to Publication 4134 if you do not know your local clinic. If your community does not have a tax clinic, you might work to create one.)

Second, I request that you join with me in seeking to create a support center for tax clinics. In the 1960s and 1970s when the Legal Services Corporation was created and being developed, the need for support centers in each of the areas of poverty law was identified. Over the decades these support centers have grown into significant repositories of knowledge and assistance to the lawyers engaged in representing individuals on the issues facing the poor in America. The support centers not only assist on individual cases but build information for broader advocacy on issues facing their constituencies. Because taxes came late to the table of low-income representation, no support center developed in the tax area at the same time.

In 1998 when Congress passed section 7526 and created the grant for low-income tax clinics, the Senate bill recognized the need for a support center and authorized use of grant funds to create and sustain a support center. The House version of the bill did not contain the provision, and ultimately the House version prevailed, meaning that all of the grant money authorized goes
directly to operating clinics. While that is not a bad result, it has meant that tax clinics have operated without the kind of overall support available in other areas of poverty law. The Tax Section, with all of the work it does, has stepped into this breach, particularly in the area of comments on proposed rule-making and also in the area of training. The National Taxpayer Advocate has also stepped into this breach, particularly in the area of research on issues impacting low-income taxpayers and also in the area of training.

Still, there exists a gap between the needs of the low-income tax clinic community and the ability of the Tax Section or the NTA to provide assistance. As my second request, I ask that members of the Tax Section join with me in seeking to create a support center that directly serves the tax clinics and provides a voice in the greater community for issues impacting low-income taxpayers. A support center focused on the issues that impact this specific community would allow for greater advocacy and research into these issues and a consistent voice to speak for the community before Congress and the Service. This is an opportunity to significantly increase the effectiveness of the representation of these clients both through greater training and also through a more unified and focused voice on important issues.

I thank the Tax Section again for choosing me for this important award and for all of the work it does to assist those who would otherwise go without representation in a complex and bewildering tax system.

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**Uncle Sam: “We Need a Few Good Tax Lawyers”—Military VITA Training Opportunities through the “Adopt-A-Base” Program**

By C. Wells Hall, III

The Section of Taxation has partnered with the U.S. Armed Forces (the “Armed Forces”) and the Internal Revenue Service (the “Service”) to train Armed Forces personnel to become return preparers for other military personnel and their families as part of the Military Volunteer Income Tax Assistance Program (VITA).

Budget constraints have made it difficult for the Service to provide in-person training for Military VITA volunteers. This is where you come in as a member of the Section of Taxation! By volunteering as a Military VITA instructor, you will help provide military personnel and their families with access to free tax preparation services that address their unique military tax issues.

Volunteers will not be preparing returns themselves, but will instead train the VITA volunteers at military installations on substantive tax issues relevant to returns prepared for Armed Forces personnel. Prior individual tax return experience is not required (although it makes the certification process easier). The Service will provide all the necessary training to participate in the program through an on-line training course, available to suit your own schedule. This is a valuable opportunity for meaningful pro bono work while fostering relationships with your local military installation and the Service.

For the 2014 filing season, Section of Taxation members provided Military VITA instruction at 24 training sites for 31 Armed Forces installations in 14 states and the District of Columbia. This is a significant expansion of the Program from 8 training sites and 9 Armed Forces installations for the 2013 filing season, and 4 Armed Forces installations for the 2012 filing season.

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**Program Participants Share Experiences**

George Howell, Chair-Elect of the Section of Taxation, led a team of tax lawyers with Hunton & Williams providing Military VITA instruction at Fort Lee in Richmond: “I had a wonderful day providing VITA instruction to the military and civilian volunteers at Fort Lee. It made me feel good to help the men and women of our Armed Forces who sacrifice so much to protect our country.”

Kevin May, of Graves and May in Wilmington, North Carolina, and Chair of the North Carolina Bar Association Section of Taxation Pro Bono Committee: “I had the honor to work with the Military VITA program covering Camp Lejeune, Marine Corps Air Station New River and Cherry Point (Jacksonville, North Carolina). The men and women who serve our country face dangers that civilians cannot understand but still have

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to deal with everyday issues at home, such as taxes. The Military VITA program is a great way for tax professionals to give back to our men and women in uniform. Our service men and women are a great group to work with, and I look forward to being a part of the program again next year.”

Jason Morton, of Morton Law Firm in Southern Pines, North Carolina, and a regular provider of pro bono services to the Armed Forces, shares his experience: “The Armed Forces, through its IRS VITA training and Tax Centers, offer soldiers and their families a tremendous service in preparing personal income taxes while at home or abroad. It was my great pleasure to assist in training-up those soldiers for their VITA and tax-prep missions. Any contribution I can make, no matter how small, to assist the Armed Forces is an experience that I take great pride in each year.”

Ruddy Ramelli of Jones Walker in New Orleans, a former Chair of the Section of Taxation, provided instruction at Naval Air Station Joint Reserve Base in New Orleans, partnering with a friend from a regional CPA firm: “I fully support the Section’s Adopt-A-Base program. What I have learned from this is that simplification is sorely needed. As a transactional tax practitioner, you think that structuring a purchase or reorg is complicated. It pales when you try to determine if a taxpayer can take a dependency exemption in a complicated family structure and which of the many education benefits the taxpayer can take. This is a worthwhile program and a great way to help the tax system remain self-compliant.”

Fred Murray, a Council Director of the Section, coordinated a team of Grant Thornton Military VITA instructors covering Beale Air Force Base, Fort Detrick, Wright Patterson Air Force Base, and Dahlgren Naval Surface Warfare – Fleet and Family Support: “Our Veterans show us citizenship, heroism, and sacrifice and what those words really mean. It’s a wonderful thing to spend time with them, and to see their appreciation for what we were doing to help them with some complex requirements of our tax Code. Many of us don’t get that kind of satisfaction and real connection when we are in our daily routines and lost in the abstractions of the Code until we do something like this.”

Susanna Ratner, one of the Section’s 2013–2015 Christine A. Brunswick Public Service Fellows working with the Senior Law Center in Philadelphia, assisted with other volunteer instructors representing the Philadelphia Bar Tax Section covering the Joint Base McGuire-Dix-Lakehurst in Trenton, New Jersey: “My experience with the Adopt-A-Base program was fantastic. The program gave me the opportunity to learn so much about tax law as applied to the Federal Income Tax return, which is useful both for my job and my everyday life. The program materials teach you everything you need to know to participate; the program motivates you to learn the entire tax return process, from the Affordable Care Act to self-employment tax. Teaching at Fort Dix was rewarding and fun. The participants were bright and engaged in the material, and as a side benefit, I also enjoyed picking out my favorite military uniform! (For the record, it’s the Navy uniform – the colors are beautiful.)”

Rawlin Tate, Coordinator, Stakeholder Partnerships, Education and Communication (SPEC) for the Service, on the Section’s involvement in Military VITA instruction for the 2014 filing season: “Working with ABA in the Adopt-A-Base Program was and still is an honor. It feels great to know that we were able to collaborate and help ease the burden of some of the men and women that serve our country by offering free tax services. To see the support for the program grow each year keeps me motivated to help ensure the program has what it needs from SPEC and we look forward to the 2015 Adopt-A-Base Program.”

What Will You Be Asked to Do If You Volunteer?

Volunteer VITA instructors will be asked to commit to the following:

- Participate in introductory conference calls with the Service, Military, and other volunteer instructors.
- Take the “Link and Learn” online training course and become VITA certified (available 24/7 at http://apps.irs.gov/app/vita/; click “Certification Paths”). Adopt-A-Base volunteers must become “advanced” and “military” certified. Problems and exercises are completed using the Practice Lab or TaxWise training mode.
- In some cases, volunteers have the opportunity to attend a two- to three-hour instructor training session with local Service and military representatives.
- Volunteers will be requested to teach tax law at a military installation a minimum of four hours per day (maximum eight hours) for up to four days, depending on the availability of local Service and military representatives. The training will be conducted in December 2015 and January 2016 for the 2015 filing season.
- Volunteers are required to notify the other instructors and provide a certified replacement instructor should a work or personal emergency occur. Teaming up with other tax lawyers to cover the training at an installation is very effective and minimizes the chance of last minute conflicts.

To Volunteer

The Section of Taxation needs “a few good tax lawyers” to fill all of the Military VITA instruction opportunities available through the Service and the Armed Forces. Numerous opportunities exist for tax lawyers to participate at local training sites. The program is a great opportunity for a young tax lawyer.
to gain public speaking experience and confidence. The military personnel appreciate the variety of experiences and backgrounds tax lawyers provide to the classroom experience.

For questions about the opportunities to volunteer as a Military VITA instructor, contact Wells Hall, Vice Chair (Pro Bono and Outreach) of the Section (wells.hall@nelsonmullins.com; 704-417-3206) or Derek Wagner, Pro Bono Staff Counsel for the Section (derek.wagner@americanbar.org; 202-442-3425).

Other Pro Bono Opportunities for Tax Lawyers

Tax lawyers can also sign up to participate in the ABA’s Military Pro Bono project. To sign up, go to http://www.militaryprobono.org and register. Once registered, you can either accept cases or offer to provide advice to Judge Advocates upon request. The registration process will ask for a practice area and other basic information.

Opportunities are available for tax lawyers to volunteer to participate in Low-Income Taxpayer Clinics (LITCs), representing low-income taxpayers before the Service, assisting taxpayers in audits, appeals and collection disputes, and helping taxpayers respond to Service notices and correct account problems.

In addition, tax lawyers can volunteer to assist pro se taxpayers appearing before the Tax Court as a part of the Tax Court’s Bar Sponsored Calendar Call Program, described on the Tax Court’s webpage at http://www.ustaxcourt.gov/clinics.htm.

Winners of the 14th Annual Law Student Tax Challenge

The Section is pleased to announce the winners of the 14th Annual Law Student Tax Challenge, a contest designed to give students an opportunity to research, write about, and present their analyses of a real-life tax planning problem. The competition is open to both J.D. and LL.M. law students.

Aaron Miki and Mikkela Sweet of the University of San Francisco School of Law were awarded first place in the J.D. Division. Their coach was Davis Yee. Riley Becker and Mary Beth Dolan of Northwestern University School of Law were awarded first place in the LL.M. Division. Their coach was Herbert Beller.

The teams presented oral arguments before a panel of distinguished tax lawyers and tax court judges attending the Section of Taxation 2015 Midyear Meeting in Houston, TX, with the winners honored at a reception during the meeting.

The other awardees from this year’s competition include:

J.D. Division:
• 2nd Place: Christine Fukushima and Tommy Du, University of California, Irvine, School of Law.
• 3rd Place: Ankur Thakkar and Thomas Vanik, Cleveland-Marshall College of Law
• Best Written Submission: Ankur Thakkar and Thomas Vanik, Cleveland-Marshall College of Law

LL.M. Division:
• 2nd Place: Jessica Cory and Morgan Klinzing, New York University School of Law
• Best Written Submission: Jessica Cory and Morgan Klinzing, New York University School of Law

An alternative to traditional moot court competitions, the Law Student Tax Challenge (LSTC) is organized by the Section’s Young Lawyers Form. The LSTC asks two-person teams of students to solve a complex business problem that might arise in everyday tax practice. Teams are initially evaluated on two criteria: a memorandum to a senior partner and a letter to a client explaining the result. Based on the written work product, six teams from the J.D. Division and four teams from the LL.M. Division receive a free trip to the Section’s Midyear Meeting, where each team presents its submission before a panel of judges consisting of the country’s top tax practitioners and government officials, including tax court judges. The competition is a great way for law students to showcase their knowledge in a real-world setting and gain valuable exposure to the tax law community. For more information about the LSTC, go to www.americanbar.org/groups/taxation/awards/law_student_tax_challenge.html.
Resident/Nonresident Distinction for Tax Purposes

For income tax purposes, noncitizens are classified into two groups: resident and nonresident aliens. These distinctions are for tax purposes only, and how a taxpayer is classified will have several repercussions on their tax treatment—for example, a nonresident alien must file IRS Form 1040NR, and is generally taxed differently than a citizen or resident alien. Resident aliens are, in general, taxable in the same manner as U.S. citizens. Reg. § 1.871-1(a).

There are two ways to qualify for resident alien status: the legal permanent resident test, and the substantial presence test. I.R.C. § 7701(b)(1)(A). Any noncitizen who does not qualify under one of these two tests is considered a nonresident alien for tax purposes. I.R.C. § 7701(b)(1)(B).

Legal Permanent Resident (“Green Card”) Test

The LPR test is generally very simple to apply—if a taxpayer is a legal permanent resident at any time of the year, they are a resident alien until such status is rescinded or administratively or judicially determined to have been abandoned.” Reg. § 301.7701(b)-1(b)(1). “Rescinded” means that a final order, no longer subject to appeal, has been issued determining that the taxpayer is to be excluded or deported. Reg. § 301.7701(b)-1(b)(2). “Abandonment” refers to a specific administrative process that may be initiated by the taxpayer, an official of the Immigration and Naturalization Service (INS), or a consular officer. Reg. § 301.7701(b)-1(b)(3).

Substantial Presence Test

Subject to some exceptions, in order to show residency under the substantial presence test, the taxpayer must be present in the United States (1) at least 31 days in the current calendar year, and (2) 183 or more total days within the current calendar year and preceding two years. I.R.C. § 7701(b)(3). Days present in preceding years are only assigned a fractional value, however, with each day counting as 1/3 of a day for the year prior to the current year, and 1/6 of a day for two years prior. The first year of residency is determined to begin the first day during the calendar year in which the taxpayer is substantially present. Reg. § 301.7701(b)-1(a)(4).

Example. If a taxpayer was present for 365 days in Year 1 (365/3 = 121.6 Year 1 days + 62 Year 2 days = 183.6 days), without even considering other prior years. For an example of how the Tax Court will weigh facts in the substantial presence test, see Lujan v. Commissioner, T.C. Memo. 2000–365.

Additionally, those subject to certain exemptions will not have applicable days count towards presence—these exemptions include certain common types of student or cultural exchange visa holders. I.R.C. § 7701(b)(3)(D), (b)(5). In addition to those falling under an exemption, commuters from Mexico or Canada, those in transit between two non-U.S. locations, and those who are prevented from leaving the United States due to a medical condition do not have applicable days counted for the purposes of the substantial presence test. Reg. § 301.7701(b)-3. To claim one of these exemptions, one must timely file IRS Form 8843. Publication 519, U.S. Tax Guide for Aliens, Internal Revenue Service, http://www.irs.gov/uac/Publication-519,-U.S.-Tax-Guide-for-Aliens-1 (last updated Dec. 3, 2013).

There is also a more general exception to the substantial presence test, however.
Even if the test is otherwise met, a taxpayer is generally not substantially present for purposes of tax residency if they (1) are in the U.S. for less than 183 days, (2) have an established “tax home” in a foreign country, and (3) have a closer connection to the country than to the U.S. I.R.C. § 7701(b)(3)(B). See also Reg. § 301.7701(b)-2. This exception will not apply if the taxpayer had a pending application to adjust status, or otherwise took steps to apply to be a legal permanent resident. I.R.C. § 7701(b)(3)(C). See also Reg. § 301.7701(b)-2(f) for a nonexclusive list of forms of the filing of which preclude the “closer connection” exception. The applicable regulation sets out in much more detail what constitutes a “tax home,” and factors which may be considered in determining closer connection. Reg. § 301.7701(b)-2(c). To claim the “closer connection” exemption from substantial presence tax residency, one must file IRS Form 8840. Publication 519, supra.

Dual-Status Aliens and the First-Year Election

A taxpayer who has both resident and nonresident status during the year can claim dual-status; in other words, they may elect to be taxed part of the year as a resident, and part as a nonresident. A dual-status alien will file both a 1040NR and a 1040 for the same year, each being limited to income earned as nonresident and resident respectively. I.R.M. 21.8.1.12. This will usually be the first and last years of residency, which makes proper calculation of when residency begins and ends crucial to determining proper taxation.

First Year

Unless the taxpayer also meets the substantial presence test in addition to the legal permanent resident test, the first year of tax residency under the legal permanent resident test begins the first day of the calendar year when the taxpayer is actually present in the United States while a lawful resident of the United States. I.R.C. § 7701(b)(2)(A)(ii). See also Reg. § 301.7701(b)-4(a). If the taxpayer previously met the substantial presence test before attaining legal permanent resident status, then the first year of residency would be determined under that test (see below).

In the first year of residency for a taxpayer qualifying under the substantial presence test, residency is deemed to begin on the first day of that calendar year they are present in the United States. For example, if a taxpayer met the substantial presence test in 2013, and her first day in the country was March 1, her residency is deemed to begin on March 1. Up to ten days of “nominal” presence may be disregarded, where the taxpayer has a closer connection to another country than to the United States. I.R.C. § 7701(b)(3)(C). For more about the definitions of closer connection & tax home, see Reg. § 301.7701(b)-2(c), -2(d). This applies to both first and last year, if the taxpayer is qualifying under the substantial presence test.

First-Year Election

The so called “first-year election” allows a nonresident alien who is a resident alien the following year under the substantial presence test to claim resident alien status for a portion of the previous year. I.R.C. § 7701(b)(2)(A)(iv). To take this election, the taxpayer must:

- Be present in the United States for at least 31 days in the year they take the election;

- Be present in the United States for 75% of the days beginning with the first day of their 31 days and the end of the calendar year. The taxpayer may count up to five days of absence during this period to count towards this subsequent period.


This election is not dependent upon being married. The first day of residency under the first-year election is the beginning of the triggering 31-day period. In order to claim the first-year election, the taxpayer must attach a statement to their IRS Form 1040. The statement must contain the following assertions:

- The taxpayer is making the election for the tax year in question;

- The taxpayer was not a resident the previous year;

- The taxpayer is a resident alien the subsequent year;

- The number of days present in the United States the subsequent year, as relevant to the substantial presence test;

- The days present in the U.S. in the relevant tax year that trigger the 31-day period;

- Any dates of absence in the relevant tax year that the taxpayer wishes to be applied to the five exempted days.

It is important to note that the first-year election cannot be taken until the taxpayer’s resident alien status in the subsequent year has been established. To the extent that this status has not been established by April 15 of the subsequent year, it may be advisable for the taxpayer to file for an extension. Any extension should include tax that would be due if the taxpayer were considered a nonresident alien. Late filers may be able to still claim the first-year election if they can demonstrate by clear and convincing evidence that they took reasonable efforts to become aware of filing procedures and took significant steps to comply. Id.

Last Year

The last year of residency for an alien taxpayer under the legal permanent resident test would generally be the last day of the calendar year that they are a legal permanent resident, unless they also meet the substantial presence test (see below). Reg. § 301.7701(b)-4(b)(1). However, if the taxpayer can demonstrate
a closer connection to a foreign country in which she maintains a tax home in the calendar year when residency terminates, tax residency is deemed to cease on the first day of that calendar year. Reg. § 301.7701(b)-4(b)(2).

The last day of residency under the substantial presence test, or if the taxpayer meets both the legal permanent resident and substantial presence tests, is the last day of substantial presence in the United States.

Spousal Elections
Under certain circumstances, a nonresident alien who is married to a U.S. citizen or an alien considered a resident alien at the end of the year may themselves be treated as a resident alien if they so elect. I.R.C. § 6013(g). The election under this section is alternative to and exclusive from the first-year election for dual-status aliens. The other spouse must agree to the election. I.R.C. § 6013(g)(2). A similar election allows a spouse who is a dual-status alien and a resident alien at the end of the year (i.e., first year of a residency period) to claim resident status even for the period where they would otherwise be considered nonresident. I.R.C. § 6013(h). Neither spouse can use the election again, even if they remarry. I.R.C. § 6013(g)(6), (h)(2).

Immigration Ramifications of Filing/Nonfiling
One major area where tax and immigration law intersect is in those situations where failure to file or other noncompliance with the tax code can negatively affect immigration status, and conversely where compliance with the law can have positive effects. This ranges from the effect of tax crimes on admissibility or removal, to how tax return information may be used to a noncitizen’s detriment, to how compliance affects adjustment of status or naturalization.

Tax Offenses As an Aggravated Felony


Crimes of Moral Turpitude
In addition to aggravated felonies, “crimes of moral turpitude” are also grounds for deportation or inadmissibility. Unfortunately, unlike aggravated felonies, the term “crimes of moral turpitude” is not clearly defined by the code or regulations. As is relevant to tax-related issues, “[c]riminal acts involving intentional dishonesty for the purpose of personal gain are acts involving moral turpitude.” Tseung Chu, 247 F.2d at 935 (quoting In re Hallinan, 307 F.2d 1, 2 (Cal. 1957).

An alien who is “convicted of, or who admits having committed, or who admits committing acts which constitute the essential elements of a crime of moral turpitude” is inadmissible. INA § 101(a)(2)(A)(i)(I), 8 U.S.C. § 1182(a)(2)(A)(i)(I). Note that inadmissibility does not require a conviction. If the maximum penalty for the crime does not exceed one year, or the actual sentence imposed does not exceed six months, then the alien remains admissible.

In regard to deportation, grounds involving crimes of moral turpitude are more narrow in some ways, requiring that a conviction has occurred within the last five years (ten for a legal permanent resident who had adjusted status from a nonimmigrant visa), or that there have been two or more such convictions. INA § 237(a)(2)(A)(i), (ii), 8 U.S.C. § 1227(a)(2)(A)(i), (ii). On the other hand, there is no exception tied to length of maximum or actual sentences.

An intent to defraud the government is a prerequisite for a criminal conviction for tax evasion, and therefore has been held in numerous instances to be a crime of moral turpitude. See Gambino v. INS, 419 F.2d 1355, 1358 (2d Cir. 1970); Serafin v. Attorney Gen. of U.S., 186 F. App’x 302, 305 (3d Cir. 2006); Chanon Din Khan v. Barber, 253 F.2d 547, 550 (9th Cir. 1958); Tseung Chu v. Cornell, 247 F.2d 929, 933 (9th Cir. 1957).

Effect of Filing/Nonfiling on Cancellation of Removal
In the case where the alien is already present within the United States, even when there are grounds to deport, that deportation may be stopped upon a showing that “the alien’s life or freedom would be threatened in that country because of the alien’s race, religion, nationality, membership in a particular social group, or political opinion.” INA § 241(b)(3)(A), 8 U.S.C. § 1231(b)(3)(A).
A PSC is yet another distinct categorization of criminal act in the immigration code, which overlaps incompletely with aggravated felonies and crimes of moral turpitude. There are two categories of PSC. First, any aggravated felony (see above) for which the alien is sentenced to over five years imprisonment is a per se PSC that disqualifies them from withholding of deportation relief. INA § 241(b)(3)(B)(iv), 8 U.S.C. § 1231(b)(3)(B)(iv). Also, the United States Attorney General has the discretion to, on a case by case basis, determine that an individual crime is a PSC based on the factors in the 1982 BIA case of Matter of Frentescu, 18 I. & N. Dec. 244 (BIA 1982). See Frentescu at 247. See also Blandino v. Holder, 712 F.3d 1338, 1343-44 (9th Cir. 2013). A crime need not be an aggravated felony to be a PSC if it meets the Frentescu factors, but aggravated felonies with a sentence under five years create a presumption the crime is a PSC that must be overcome by the alien.

The factors in Frentescu are:

- The nature of the conviction;
- The circumstances and underlying facts of the conviction;
- The type of sentence imposed; and
- Most importantly, whether the type and circumstances of the crime indicate that the alien will be a danger to the community.

While some violations of the criminal provisions of the Internal Revenue Code may be aggravated felonies (see above), only some of these offenses carry a maximum sentence of five years. See I.R.C. §§ 7201–7217 (None are over five years.). Thus, unless the maximum sentence is imposed, each case must be analyzed on a case by case basis under Frentescu. Courts have not yet analyzed a tax related crime under Frentescu. Frentescu’s emphasis on the alien posing a danger to the community seems to weigh against categorizing property crimes as PSC, as opposed to crimes where there are human victims, although this is not a guaranteed outcome. At least one case has found a felony money laundering conviction to be a PSC. See Hakim v. Holder, 628 F.3d 151, 154 (5th Cir. 2010) (finding the connection between money laundering and drug activity brought the Attorney General’s designation within the bounds of justifiable discretion).

Even if it is determined that a commission of a particularly serious crime, the alien may still qualify for relief barring deportation under the Convention Against Torture (CAT). 8 C.F.R. § 208.16-18 (2014).

Effect of Filing/Nonfiling on Adjustment of Status

A nonimmigrant may apply to change their status to an immigrant through a process called “adjustment of status.” See INA § 245, 8 U.S.C. § 1255. This is done by filing a Form I-485. There are many different ways that nonfiling can prevent a nonimmigrant from adjusting status. First of all, as may be expected, a crime of moral turpitude that would preclude admissibility would also necessarily preclude adjustment of status. Chak Yiu Lui v. Holder, 600 F.3d 980, 984 (8th Cir. 2009). Secondly, compliance with tax laws is a helpful factor when determining whether an applicant presents good moral character.

Taxpayers should also be aware that tax returns may be heavily scrutinized in less direct contexts that can also affect adjustment of status. For example, how one characterizes their family composition on their tax return will be grounds to refuse testimony from other sources, and any inconsistency can both bar adjustment of status and lead to removal. See Akwasi Agyei v. Holder, 729 F.3d 6, 11 (1st Cir. 2013).

Also, when an adjustment of status is done with the involvement of a sponsor, the sponsor must both have filed tax returns for the last three years, as well as provide a copy of the most recent return as an attachment to Form I-864. INA § 213A(f)(6)(A)(i), 8 U.S.C. § 1183a (f) (6)(A)(i). Any dependents claimed on the most recently filed tax returns must also be added to the I-864. 8 C.F.R. § 213a.1(1) (2014). The greater the number of dependents claimed by the sponsor, the more of a chance that the adjustment of status will fail on the basis of the applicant being likely to become a public charge. 8 C.F.R. § 213a.2(c)(2)(ii) (B) (2014).

Effect of Filing/Nonfiling on Citizenship

Good moral character is one factor that must be proven in order to successfully complete the naturalization process. 8 C.F.R. § 316.10(a)(2) (2014). Timely filing for and payment of taxes is a factor that will weigh in favor of an immigrant seeking to become a citizen through the naturalization process, in that it shows good moral character. See Iqbal v. Bryson, 604 F. Supp. 2d 822, 828 (E.D. Va. 2009).
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Congress enacted section 1031(a)(3) in 1984. That provision allows for deferred exchanges that satisfy the identification and exchange timing requirements. The 1984 legislation also prohibited the application of section 1031 to exchanges of partnership interests. In 1989, Congress added section 1031(f), limiting the benefits of like-kind exchanges between related parties, and section 1031(h), treating U.S. property as being not of like-kind to foreign property.

Administrative regulations and rulings have also actively contributed to the law under section 1031. In 1991, the Service issued extensive regulations that created exchange safe harbors, including the qualified intermediary safe harbor, to help exchangers more easily accomplish transactions that the Service deemed to come within the section 1031 definition of exchange.

The Service also provided substantial guidance on how to structure reverse exchanges, improvement exchanges, leasehold improvement exchanges, and program exchanges with certainty that the Service will not challenge the application of section 1031 to such transactions. The Service also provided specific guidance about the nature of tenancy-in-common interests and interests in certain statutory trusts that hold real estate. With that guidance, exchangers can be comfortable that a long-held fee interest in real property can be like kind to an interest in a properly structured Delaware statutory trust held by numerous other owners throughout the country. Needless to say, the current application of section 1031 is significantly different from its application in 1921 when its predecessor became part of the law.

Every exchanger must report like-kind exchanges on Form 8824. Published data from recent tax years reveals that individuals file more than 60% of all filed Forms 8824. Corporations account for about 30% of filed returns, but they account for almost 60% of all reported deferred gain. The table below summarizes these numbers.

### Form 8824 Data for Tax Year 2011

<table>
<thead>
<tr>
<th>Item</th>
<th>Line No.</th>
<th>Amount</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FMV of other property given up</td>
<td>12</td>
<td>$289,416</td>
<td>$430,345</td>
<td>$726,115</td>
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<tr>
<td>Adjusted basis of other property given up</td>
<td>13</td>
<td>$68,974</td>
<td>$205,219</td>
<td>$34,677</td>
</tr>
<tr>
<td>Gain (or loss) recognized on other property given up</td>
<td>14</td>
<td>$220,442</td>
<td>$225,127</td>
<td>$691,439</td>
</tr>
<tr>
<td>Cash received, FMV of other property received, plus net liabilities</td>
<td>15</td>
<td>$1,787,432</td>
<td>$1,914,721</td>
<td>$1,408,502</td>
</tr>
<tr>
<td>FMV of like-kind property received</td>
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<td>$15,311,387</td>
<td>$35,229,605</td>
<td>$15,107,374</td>
</tr>
<tr>
<td>Adjusted basis of like-kind property given up</td>
<td>18</td>
<td>$12,377,383</td>
<td>$15,110,927</td>
<td>$9,198,798</td>
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<tr>
<td>Realized gain (or loss)</td>
<td>19</td>
<td>$4,721,435</td>
<td>$23,711,560</td>
<td>$10,132,650</td>
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<tr>
<td>Ordinary income under recapture rules</td>
<td>21</td>
<td>$52,829</td>
<td>$2,651,711</td>
<td>$279,086</td>
</tr>
<tr>
<td>Recognized gain</td>
<td>23</td>
<td>$849,498</td>
<td>$3,142,592</td>
<td>$918,758</td>
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<tr>
<td>Deferred gain (or loss)</td>
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<td>$3,871,938</td>
<td>$20,601,736</td>
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<tr>
<td>Basis of like-kind property received</td>
<td>25</td>
<td>$11,439,449</td>
<td>$17,114,754</td>
<td>$12,269,709</td>
</tr>
</tbody>
</table>

Source: Internal Revenue Service, Statistics of Income Division.
major American companies “pushing the boundaries” of section 1031, have fueled the appetite for repeal. To be sure, budget estimates may show partisan bias, but the scope of the number utilized by the Obama administration at least provides a sense of the maximum expenditure represented by current law.

Inequitable Distribution of Section 1031 Benefits

Section 1031 is the third largest corporate tax expenditure, estimated to reduce revenues by $11.7 billion in 2014. Supporters of section 1031 may argue that if it is repealed, taxpayers will simply use other strategies like investment in real estate investment trusts, holding property in partnerships, or cross-renting arrangements. However, these arguments do not support retaining section 1031, although they may support reform of other provisions.

There is little data on the distributional impact of section 1031. However, various studies show that the preferential tax rate for capital gains disproportionately benefits the wealthiest of taxpayers. For instance, the Congressional Budget Office estimates that taxpayers in the top 1% receive 68% of the benefit of low tax rates on capital gains and dividends, while the bottom 80% will receive only 7%. As section 1031 allows tax deferral upon the transfer of investment property that would otherwise frequently produce capital gains for individuals, it is likely that section 1031 benefits the same sort of taxpayer. Section 1031 is unlikely to benefit small investors because the gain deferral would not be enough to offset the costs of the exchange, which generally include hiring an accommodator to facilitate the exchange. Additionally, the transaction cost of hiring an accommodator would be a larger percentage of the tax benefit gain on the exchange of lower-value property. Finally, the data from Form 8824 shows that corporations derive the greatest tax benefit from section 1031, suggesting that the benefit goes to the largest taxpayers.

Overinvestment in Like-Kind Property Causes Economic Distortion

Section 1031 encourages reinvestment of exchange proceeds in property that is like kind to relinquished property. Thus, section 1031 encourages what might be called “asset-type lock-in effect.” For instance, exchangers lock in to holding real estate, if their initial investment was in real estate. Without section 1031, those same investors might diversify their holdings. By encouraging reinvestment in like-kind property, section 1031 may artificially inflate the value of property that qualifies for section 1031 treatment. Any inflated values affect investor decisions and further distort economic behavior.

Calls for retention of section 1031 come loudest from the real estate and qualified intermediary industries. They predict disaster and economic collapse if the prop of section 1031 is removed. These predictions are undoubtedly biased. The Federation of Exchange Accommodators (FEA), an industry group representing section 1031 exchange accommodators, argued that the Joint Committee on Taxation (JCT) estimates of revenue lost to like-kind exchanges in 2010 were overstated, based on a survey of their customers. JCT’s 2010 estimate of the revenue loss from section 1031 was $2.1 billion. The actual deferred gain based on Forms 8824 filed in 2010 was $40 billion, which, if one were to calculate tax savings using a conservative 15% capital gains rate, would translate to $6 billion of revenue loss. As there was likely some recapture and higher rate capital gain in the mix, the JCT’s estimate rather than overstating, significantly understated the revenue loss.

One argument is that even though the government loses revenue when a property owner transfers property and exchanges up into more expensive property, the government effectively becomes a partner in the reinvested capital and shares in the revenue generated from the reinvestment. This argument requires several assumptions that may not play out with regularity, and, if they do, they may be the result of economic distortion. First, the argument assumes that the property owner’s reinvestment of saved taxes provides a greater economic good than would the government using those funds to provide important services. Second, to exchange up in a transaction, a property owner must have additional capital, obtained through borrowing or already in the property owner’s possession. For the partnership argument to have meaning, one must assume that the property owner would only invest that money if it were able to do so through a like-kind exchange. Most property and business owners will, however, seek to put all available capital to its most productive use. If so, the government will enjoy the benefit of a constructive partnership with the property owner whether the owner uses available capital to invest in like-kind property or uses the capital to invest in different property. The government stands to gain from either type of investment; the government would, however, also prefer that its constructive partner, the property owner, put the capital to its highest and best use. Certainly the best investment is not always in like-kind property. Because section 1031 encourages reinvestment in like-kind property, it causes economic distortions.

Administrative Burden

The common law definition of exchange allows exchangers to engage in multiple-party deferred exchanges, but prohibits exchangers from actually or constructively receiving non-like-kind property as part of the transaction (such property is taxable boot, which can trigger gain recognition). The regulations promulgated in 1991 create safe harbors that help exchangers gain confidence that they are avoiding the
actual or constructive receipt of non-like-kind property. Nonetheless, those safe harbors create an administrative burden for exchangers, impose external costs on the transaction, and appear to provide no nontax benefits to exchangers.

The structure of section 1031 exchanges has been shaped by litigation. The Service has responded to litigation losses by adapting its administration of section 1031. Based on a recent search in CCH IntellIconnect, just since 1994, the Service has litigated 219 cases involving section 1031 and published 20 revenue rulings, seven revenue procedures, and 49 regulations projects related to section 1031. The Service has also issued at least 90 private rulings and several private memoranda since 1994. The section 1.1031(k) regulations governing deferred exchanges alone cover 15 pages. The most recent statistics indicate that over 100,000 like-kind exchanges were reported in 2011 by filing Form 8824. The instructions to Form 8824 estimate 15 hours of paperwork burden per form filed, which amounts to a huge taxpayer burden and does not account for the Service burden of processing those forms. To be sure, some of the administrative burden will not seem salient to taxpayers because taxpayers will turn to intermediaries in order to navigate the complexity.

Debunking Arguments for Retaining Section 1031

Despite section 1031’s defects, many voices support it with various arguments. The most often stated reasons for retaining section 1031 appear to be “administrative convenience” and “continuity of investment.”

One early justification for tax-free exchanges was that if like-kind exchanges are not currently taxed, then the Service will not be burdened with attempting to value property and enforce compliance. Today, the vast majority of like-kind exchanges, according to a February 2013 FEA report, are accomplished through third-party intermediaries who accept cash for the relinquished property and pay for the replacement properties with such cash. Thus, the value of the property is known and computing taxation of gain on an exchange would not impose an undue burden. Consequently, value-based arguments in support of section 1031 are outdated.

Aspects of section 1031 exchanges that make valuation a non-issue also create administrative inconvenience. Both taxpayers and the Service suffer considerable inconvenience in structuring and reviewing section 1031 exchanges. Taxpayers must meet detailed requirements to obtain the tax deferral benefits of section 1031, requirements that may be difficult to satisfy when dealing with buyers and sellers who do not care whether the transaction qualifies. The Service has been burdened with analyzing and providing guidance for ever more complex transactions, structured so that the taxpayers can do the transaction they want and still obtain the favorable tax treatment they desire.

The continuity-of-investment rationale provides that as the taxpayer remains invested in like-kind property, taxation is inappropriate. The taxpayer has not liquidated its investment and has no funds to pay the tax. Imposing a tax on the disposition of property discourages the taxpayer from shifting its investment funds to other, more profitable, investments and thus locks capital into a specific asset (asset-specific lock-in effect), so the capital is not used in the most economically efficient manner. As discussed below in the section on reform, the current like-kind parameters arguably do not appropriately incorporate the continuity-of-investment rationale, but the continuity-of-investment norm could be used to craft a policy-justified definition of like-kind property.

Arguments for Retention of Section 1031

In 2014, the U.S. Treasury’s Office of Tax Analysis (OTA) recapped the history and policy rationale underlying section 1031, as follows:

One of the arguments for not treating the exchange of like-kind property as a realization event is that the taxpayers were continuing their on-going investment in the same business activity rather than cashing in their investment. In addition, Congress recognized that the dramatic increase in tax rates on capital gains during World War I had created substantial lock-in effects that greatly interfered with normal business transactions. Exchanges of property would be discouraged because there wouldn’t be enough money left after paying the capital gains tax to purchase a replacement property of comparable value. Persuaded by these arguments, Congress has allowed capital gains taxes to be deferred in such exchanges since 1921 with only modest changes in the rules.

The like-kind exchange rules today found in section 1031 have been around for almost a century, and appear to provide the beneficial objectives that Congress intended when it first adopted these rules in 1921. Congress sought to encourage reinvestment in existing businesses, and to counter the “asset-specific lock-in effect,” by specifically permitting tax-free exchanges of qualifying property. Congress wanted to promote economic growth, advancements in technology, job growth, and growth in government tax revenues, and Congress correctly foresaw that these worthy goals would be stymied if upgrading business and investment assets were treated as a taxable event.

If these time-tested provisions are now repealed, aging capital equipment will be retained instead of upgraded; real estate utilization will become increasingly inefficient; and the biggest loser would be the federal Treasury, which is the single biggest financial beneficiary of the reinvestment transactions explicitly promoted by section 1031.
Continuity-of-Investment

Section 1031 is not the only provision to limit the taxability of exchanges. A presumption of taxability for exchanges may be enshrined in section 1001, but this presumption is less robust than it may initially appear. Consider, for example, the various nonrecognition provisions that apply to the organization and reorganization of corporations and partnerships. Taxpayers also have the ability to defer gain on the happening of casualty or condemnation events through a qualifying replacement of the damaged property. Further, the Treasury has the ability to contest taxpayer losses when the substance of a transaction suggests that no beneficial change has occurred, and the codified wash sale rules provide specific limits on the ability to deduct losses on nonsubstantive sales of securities. The list of exceptions goes on and on.

The common thread in all these exceptions is that the taxpayer has not really changed its position but instead has economically continued its position. This continuity-of-investment rationale has been embraced by all three branches of government where like-kind exchanges are concerned. As the Second Circuit noted in Jordan Marsh v. Commissioner in 1959: “Congress was primarily concerned with the inequity, in the case of an exchange, of forcing a taxpayer to recognize a paper gain which was still tied up in a continuing investment of the same sort.”

The continuity-of-investment norm is efficient and supports a comparative equity analysis for retention of like-kind exchanges. It is a standard observation that a tax system should prioritize taxing inelastic transactions—transactions that taxpayers engage in primarily because of nontax goals or constraints. The argument is that taxing such transactions will have minimal effect on taxpayer behavior. On the other hand, taxing elastic transactions will trigger changes in taxpayer behavior: they will reduce or cease engaging in the transaction or incur planning costs to minimize or avoid the tax.

While the logic of this line of reasoning is fairly uncontroversial, it would be costly and difficult (if not impossible) to discern and measure elasticities with precision. In addition, taxing solely through reference to elasticities would almost certainly raise distributional fairness issues since a tax on some of the most inelastic transactions—for example, basic food and housing purchases—would be highly regressive. A reasonable second best alternative for the tax system is to develop administrable proxies for elasticity and to select those proxies that raise fewer distributional concerns.

The continuity-of-investment principle is arguably one such workable proxy for elasticity. After all, if a taxpayer is not substantively changing its investment and is instead merely continuing the same investment, such a transaction is far more likely to be tax elastic. That is, the taxpayer could elect not to engage in the transaction or could pay more (though less than the tax that would be owed) to construct an economically similar but nontaxed transaction.

Proponents of the like-kind exchange rules argue that the current rules are already consistent with the continuity-of-investment principle. The like-kind exchange rules also do not operate in isolation. In particular, if taxpayers hold property until death the tax basis in the property is stepped-up to fair market value, permanently eliminating the deferred gain. This opportunity amplifies the incentive taxpayers would have, if the like-kind exception were repealed, to change their transactional behavior rather than accept the tax.

Distributional and Comparative Equity

Efficiency is, of course, only one important tax policy criterion. Distributional and comparative equity considerations are also critical to tax design. The current like-kind exchange rules do not raise significant concerns with respect to equity. Like-kind exchanges are accessible to and widely utilized by individuals, including small investors holding a single rental property. To be sure, wealthier corporations and individuals also have access to the benefits of the like-kind exchange rules, but it is also worth considering that like-kind transactions for wealthier individuals and corporations may be more tax elastic because these taxpayers may have greater access to alternative planning techniques.

Comparative equity—that likes should be treated alike—is often used as an argument for repeal, but that critique assumes that the proper comparison is between taxpayers who engage in like-kind exchanges and those who engage in taxable exchanges. If the proper comparison is instead between taxpayers who continue their investment through like-kind exchanges and those who continue their investment by simply holding the same property, then comparative equity supports retention.

As a policy norm, comparative equity is problematic precisely because so much depends on which taxpayers and which transactions are being compared. Its importance remains, however, because comparative equity often resonates with intuitive perceptions of fairness. If more serious repeal proposals were advanced in the legislature, it is likely that outright repeal would strike many individuals as unfair, particularly when the continuity-of-investment norm is at its strongest.

Reinvestment Is the Wrong Time to Tax

U.S. income tax law broadly accepts that the “right” time to tax appreciation or gain in an ongoing business or investment activity is when the taxpayer is “cashing out” its investment, and not when the activity is merely being “restructured” for reasons of economic efficiency. Section 1031 provides nonrecognition when a taxpayer is merely replacing older, worn-out equipment with new equipment, or is
moving its business operations from an existing facility to a new, more efficient facility. The laudable policy underlying section 1031 is to encourage a more efficient use of existing resources and, correspondingly, not to discourage economically valuable upgrade transactions by imposing a tax event.

The Treasury OTA’s explanation quoted above specifically notes that taxing restructuring transactions would create a “substantial lock-in effect that greatly interfered with normal business transactions.” The lock-in effect is a real phenomenon: where there is discretion or any modicum of tax elasticity, taxpayers simply do not voluntarily inflict major tax costs upon themselves. As one simple but illustrative example, large U.S. corporations retain offshore literally trillions of dollars of foreign income in controlled foreign corporations, and do not repatriate these funds back to the United States because they have a choice and choose not to trigger a current tax event. That is the predictable human behavior that underlies the “lock-in” effect and that section 1031 is designed to ameliorate.

The crucial point is that taxpayers respond to taxes in very smart, aggressive, and sophisticated ways. There are many alternative ways to structure business transactions so as to maintain tax liquidity (meaning nonrecognition of immediate gain) even if section 1031 were repealed. For example, a taxpayer can rent the property that it owns currently to the party that should be the next owner, and can rent the property that it would otherwise like to acquire as replacement property from that property’s current owner. These “work around” structures would very likely be far less efficient arrangements than exchanging the relinquished property for the replacement property, but cross-renting would almost certainly be preferable to paying tax at a rate of 40% or more on what would otherwise be a rational reinvestment transaction.

Perhaps the most important observation by Treasury is that “exchanges of property would be discouraged because there wouldn’t be enough money left after paying the capital gains tax to purchase or replace a property of comparable value.” That is why section 1031 arguably represents excellent fiscal policy. Taxpayers redeploy the economic value from the relinquished property and reinvest it in new property of comparable or greater value. If taxpayers choose to extract money in the course of an exchange, these cash proceeds are taxed first, up to the full amount of the built-in gain. This can be contrasted with installment sale rules under section 453, where gain is recognized proportionately, or with the rules governing entity distributions, such as section 301 or section 731, where tax basis is recovered first and built-in capital gains are taken into account thereafter. The point is that section 1031 is not a tax give-away: it is arguably tailored so that gain recognition is avoided only if funds are fully reinvested in the applicable business or investment activity.

The “Lock-In Effect:” Myth or Math?

The following example illustrates the asset-specific lock-in effect. Taxpayer A owns an airplane used for transportation purposes in A’s trade or business. Assume the current airplane (“Old Jet”) was originally purchased for $12 million, has been depreciated down to zero for federal income tax purposes, and is still worth $10 million.

Assume A sells Old Jet for $10 million in a taxable transaction and the gain is taxed at a 40% rate. A would owe $4 million of tax and would then have $6 million of after-tax proceeds left for personal purposes or to reinvest. A may be reluctant to sell a $10 million asset if the sale leaves him with just $6 million to reinvest after paying taxes.

Of course, if A intends to retire, imposing tax at this time is appropriate, and that is how section 1031 works. But assume instead that A seeks to upgrade his business by replacing Old Jet with a new airplane (“New Jet”) costing $20 million. This would be a bad time to impose tax on A—bad for A, but also bad for the economy and especially bad for the Treasury (as explained below). Fortunately, section 1031 allows A to exchange Old Jet for New Jet and improve the efficiency of his business without incurring a current tax.

Under section 1031, A can invest an additional $10 million (either self-funded or borrowed) and add this to the $10 million realized on the sale of Old Jet, in order to purchase New Jet for $20 million. By contrast, if the sale of Old Jet were fully taxed, A would need to raise an additional $14 million—$4 million to pay the tax plus an additional $10 million to purchase New Jet, an increase of $4 million. The tax would discourage A from engaging in the transaction, thus “locking-in” his investment in Old Jet. Because section 1031 helps alleviate this type of asset-specific lock-in effect, it helps to eliminate economic distortions.

Section 1031 Creates Constructive Partnership

Two contrasting examples present the argument that the government may actually gain revenue if the transaction described above is structured as a section 1031 exchange.

**Example 1.** Assume the exchange of Old Jet for New Jet qualifies for section 1031 nonrecognition. A has acquired New Jet without paying a current (immediate) tax of $4 million, but the Service will soon be paid this additional $4 million amount in full! That is because, under section 1031, A will have only $10 million of depreciable tax basis in New Jet, even though the purchase price is $20 million. (Section 1031 mandates carry-over tax basis, adjusted upward by the additional cash invested by A.) The missing tax basis translates into an additional $4 million of taxes over
the next six years (the depreciation period of New Jet if it is classified as five-year property under MACRS).

Example 2. Assume A structured the transaction instead as a $10 million taxable sale of Old Jet and paid $4 million in taxes. He would now have to come up with $14 million (instead of $10 million) in order both to pay taxes and to buy New Jet for $20 million. However, A would then have an extra $10 million of tax basis in New Jet, and would claim these depreciation deductions over the next six years. (In fact, if Congress continues to extend bonus depreciation and greatly enhanced section 179 deductions in 2015, A would write off much or all of this additional $10 million of tax basis in the very first year.) That $10 million of additional depreciation would result in a projected $4 million reduction in A’s taxes over the next six years.

These examples show that section 1031 is essentially a timing provision that affects when tax is imposed. In Example 2, A pays $4 million up front to Treasury, but then this same amount is “returned” to him over the next six years thanks to the extra $10 million in depreciation deductions. Economically, A has effectively lent $4 million to Treasury tax-free, which is then rapidly repaid to A in the form of tax deductions. The government’s borrowing costs are low, so an interest-free six-year loan has limited value. Assuming five-year property under MACRS depreciation and using the mid-term AFR rate for January 2015 of 1.75%, the value of this $4 million loan is about $125,000. If 50% bonus depreciation is again adopted in 2015 (as it was in 2014), the value of the loan is about $62,000. On a $10 million sale-and-acquisition transaction, $62,000 is a 0.6% effective tax rate.

Conversely, if section 1031 is available, Treasury loses this immediate $62,000 economic benefit, but A may be more likely to engage in an upgrade transaction—the “unlocking” effect. This will confer an economic benefit to A. But it is also an economic benefit to the economy: A will probably employ additional employees, the vendor of New Jet will benefit, as will the vendor’s employees, as will everyone who sells goods and services to the vendor, or to A, etc., etc. This multiplier effect is the economic inverse of the asset-specific lock-in effect.

The Partnership Approach to U.S. Income Taxation

Tax law could be considered a partnership agreement between A and Treasury. The taxpayer puts up the capital, and the government puts up infrastructure, roads, education, and laws. The government can modify this arrangement unilaterally. The same partnership arrangement is made with all taxpayers.

A gets the federal government (and usually one or more state governments) as partners in his business, whether he wants that or not. A puts up all the money, and takes all the risks. If the partnership venture is successful, the governments take 40% or more of the taxable income. But Treasury enjoys additional benefits, because Treasury has the same partnership with everyone else involved, directly or indirectly, in A’s business. Treasury will collect income taxes from A’s employees, from the vendor of New Jet, from that vendor’s employees, from A’s other vendors, from the vendors to the New Jet vendor, etc., etc. Treasury will also collect employment taxes and unemployment taxes, federal excise taxes imposed on aviation fuel, on telephone usage, and other transactions.

Thus, section 1031 promotes business investment; business investment has a multiplier effect on the economy, including government revenues. Lawmakers clearly recognize that capital investment by taxpayers is a good thing, and in recent years have provided huge incentives to reward investment, including bonus depreciation and greatly increased deduction limits under section 179.

In 2009, the federal government adopted a “Cash for Clunkers” program, which was designed to encourage car owners to turn in old “clunkers” and purchase new vehicles. The Cash for Clunkers Program was comparable, both in policy and in practice, to section 1031. Thanks to section 1031, every commercial airline fleet regularly upgrades, modernizes, and expands its fleet of airplanes, thereby enhancing the comfort and safety of the passengers. Likewise, every car rental company regularly upgrades and expands its fleet, taking older cars out of rental use and substituting new, low-mileage cars with the latest technologies for safety and gasoline efficiency. What the Cash for Clunkers Program did for a brief period of time, section 1031 does quietly but with enormous efficiency, year in and year out, for the benefit of everyone concerned.

Provisions like bonus depreciation and section 179 do not necessarily promote upgrading of equipment or prudent redeployment of capital. These provisions reward, without qualification, all new purchases. The underlying message is “Go spend money.” But section 1031 is expressly designed to reward the upgrading and reinvestment in an existing business. The underlying message of section 1031 is “Go spend money wisely.” Section 1031 directly encourages replacing and upgrading business assets, and promotes economic growth far more effectively than bonus depreciation and section 179, and does so for the benefit of all, including Treasury.

Potential Avenues for Section 1031 Reform

As an alternative to outright repeal or outright retention, Congress could also consider amending section 1031. Two mutually-compatible amendments in particular are often suggested for enhancing the equity and efficiency of section 1031. First, Congress could narrow the definition of like-kind property to better support the
continuity-of-investment norm. Second, Congress could change section 1031 to a rollover provision to reduce complexity and promote equity. The first suggestion would make section 1031 exchanges somewhat less common, while the second provision would make them considerably more common.

Amend the Definition of Like-Kind Property
When section 1031 was first enacted, Congress arguably did not anticipate that it would eventually apply to the exchange of raw land in Iowa for a condo in Miami, a warehouse in Memphis for an oil and gas interest in Williston, or a water right in Arizona for an undivided interest in a commercial building in Brooklyn. This broad definition of like-kind property arguably now does more than merely facilitate the continued investment in similar property.

The equity justification for section 1031's continuity-of-investment argument best applies, however, if it helps property owners do tax free what a property owner would do tax free without disposing of property. For example, a person can construct improvements on raw land tax free. Consequently, the continuity-of-investment argument would appear to support the tax-free exchange of raw land for a building. Absent section 1031, however, a person cannot, in a tax-free transaction, convert fee ownership in raw land into an undivided interest in that land, a mineral interest in the land, water rights related to the land, or air rights. Consequently, the continuity-of-investment norm arguably does not justify the broad interpretation of like-kind property that currently allows tax-free exchanges of such properties under section 1031.

The efficiency argument presented above also supports a narrower definition of like-kind property. Under that argument, section 1031 should apply to tax elastic exchanges; i.e., those a property owner would not engage in if a tax were imposed. Determining whether an exchange is tax elastic or inelastic would require significant analysis. Take, for instance, the example of an owner of an old airplane who wishes to replace it with a new, faster, larger airplane. Tax resulting from the disposition of the old airplane would be just one factor that the owner would consider when deciding whether to upgrade to the new airplane. Other factors would include the owner's need for additional speed and the economic or psychological benefit to be gained from a larger, more luxurious airplane. If those nontax factors outweigh the tax, then the transaction becomes tax inelastic. In such situations, tax would not create asset-specific lock-in effect, and section 1031 merely creates a windfall. Similarly, the decision to upgrade rental car fleets and commercial airplanes is likely driven primarily by market factors and regulation rather than any tax imposed on the disposition of assets. Perhaps section 1031 provides opportunities to pass savings on to customers in such situations, but it seems unlikely to be a key factor in an upgrade decision. Thus, even though taxing gains does have asset-specific lock-in effect, the scope and extent of that effect should help define the parameters of section 1031. Undoubtedly, many property owners would do exchanges without the benefit of section 1031, and if asset-specific lock-in effect is the justification for section 1031, it arguably should be used only when it ultimately tips a taxpayer's decision to exchange or not to exchange. Congress could better fine-tune the definition of like-kind property to reach the appropriate calibration of section 1031's scope in this area.

One possible modification would be to narrow the definition of like-kind property for section 1031 by adopting the section 1033 standard of "similar or related in service or use." According to a May 2011 report by the FEA, its members reported that 75% of the section 1031 exchanges they facilitated would meet the stricter section 1033 standard of similar or related in service or use. According to that report, a significant majority of all exchanges would qualify for section 1031 nonrecognition under the narrower definition of like-kind property, but some would not qualify, thereby helping to narrow federal budget shortfalls. Among other benefits, using the familiar section 1033 standard would likely reduce administrative burden relative to adopting an entirely new standard, because of the long history of applying the section 1033 standard.

Convert Section 1031 to a Rollover Provision
Congress could alternatively consider converting section 1031 to a rollover provision. The current definition of section 1031 prohibits an exchanger from actually or constructively receiving exchange proceeds and appears to prohibit the receipt of replacement property prior to the transfer of relinquished property. Exchangers hire accommodators to ensure that they do not actually or constructively receive exchange proceeds and to defer the acquisition of replacement property when needed. One concern is that the use of accommodators adds cost and complexity to section 1031 exchanges, and that Congress could fix those aspects of section 1031 by converting it to a rollover provision. For example, section 1031 could be modified to allow exchangers to apply section 1031 to any disposition and acquisition of like-kind property that occurred within a certain period of time of each other—perhaps 180 days. This type of rollover provision would reduce or eliminate the need for qualified intermediaries and other accommodators in the exchange transaction and should make section 1031 available to a broader cross-section of property owners. In fact, tax systems in other developed economies allow rollovers.

Any time intermediaries are used, costs are added. The issue is whether the costs of intermediation are worth the benefits the intermediaries provide. One argument is that accommodators help to police section 1031 exchanges.
by ensuring that exchangers properly identify exchange properties within the required time period, that they acquire like-kind property, and that they complete exchanges within the required time period. Even if most accommodators help ensure that exchanges comply with the law, surely some are “accommodating accommodators” that will assist exchangers with transactions that do not satisfy the requirements. For example, such a bad apple could help an exchanger back date documents to create the appearance that the client satisfied the identification requirement. A bad apple could also knowingly facilitate the transfer of property such as a mortgage or a contract, which is not like kind to other real property, to an exchanger as part of an intended real property section 1031 exchange. In extreme cases, accommodators have mismanaged or embezzled exchange proceeds, causing inefficiencies and delaying disbursement of exchange proceeds. Even if there are only a few bad apples, they could have an outsized impact and cause the proverbial spoiling of the whole barrel.

Fortunately, defalcations appear to be the exception to the general practice of good accommodator behavior. Without regular audits of accommodators, however, taxpayers cannot assess whether they should incur the costs of intermediation. The FEA may not be suited or designed to regulate its membership in such a way that encourages accommodators to help ensure that exchangers comply with the section 1031 requirements. If not, then there appears to be limited justification for the complex, accommodator-facilitated method we currently have. One of us (Jay) is, however, convinced through his work in this field that the current system of intermediation helps the vast majority of taxpayers and provides economies of scale that make it substantially certain that the benefits of intermediation outweigh the costs.

A rollover system would most likely result in lost revenue because more transactions would qualify for section 1031 nonrecognition, but Congress could make up for that lost revenue by narrowing the definition of like-kind property and by limiting section 1031 nonrecognition to small transactions. Thus, although a “simpler” rollover version of section 1031 would have appeal on its face, it could require major modifications to an area of the Code that already functions reasonably well and that arguably is among the least of many pressing tax problems. U.S. tax law, by universal agreement, is overly complex and confusing. At the very least, great care would need to be taken to ensure that a rollover provision eased complexity rather than simply shifting it to other areas. It should also not provide fodder to unscrupulous tax preparers, to whom a rollover may prove a tempting target for new sources of fast refund claims or even identity theft. If that care is taken, any new costs that result from a rollover provision could potentially be offset by the savings that result from reducing intermediation costs. ■

ARMANDO GOMEZ | FROM THE CHAIR continued from page 3

networks that can help provide you with opportunities to take on pro bono assignments. Whether it be volunteering to help prepare wills for the terminally ill, learning how to serve as a guardian ad litem to help protect the interests of children or seniors, or defending the rights of low-income tenants in disputes with their landlords, there are myriad opportunities to give back in every community. Another priority that the American Bar Association has identified is providing representation for juveniles caught up in immigration proceedings. And if civil rights or criminal justice is your passion, there are always opportunities to help out, including in habeas proceedings for indigent defendants, preparing amicus briefs, or advocating or educating others on these important issues.

The comments to Rule 6.1 make clear that the breadth of pro bono opportunities are intended to ensure that all lawyers can give back to the legal system through pro bono work. For example, the goal of providing at least 50 hours of services to persons of limited means can be accomplished through direct representation, legislative lobbying, administrative rulemaking, and training and mentoring others who will represent persons of limited means. So even government lawyers, whose work restrictions may limit their ability to provide direct representation in certain areas, can still participate in pro bono activities.

If you are interested in learning more about tax related pro bono opportunities, please take a look at the Tax Section’s website (http://www.americanbar.org/groups/taxation/tax_pro_bono.html) or contact the Tax Section’s Pro Bono Counsel, Derek Wagner, who can be reached at the Tax Section’s office in Washington, D.C. For nontax related pro bono opportunities, contact your local bar association or the ABA Standing Committee on Pro Bono & Public Service.

Tax Law Improvement

Rule 6.1 also encourages lawyers to participate in activities for improving the law, the legal system, or the legal profession. By becoming more active in the work of the Tax Section, you can fulfill this goal. For example, the Tax Section is regularly called upon to provide comments on proposed regulations or other guidance, and we
COMMITTEE SPOTLIGHT

Transfer Pricing Committee Hosted a Student Symposium at the Tax Section’s Midyear Meeting

The Transfer Pricing Committee, chaired by E. Miller Williams (Ernst & Young, Washington, D.C.), sponsored a special Student Symposium on Thursday afternoon at the Tax Section’s Midyear Meeting in Houston. With assistance from Dr. Lorraine Eden (photo left), a professor of management and an associated faculty member at Texas A&M University’s Bush School of Government and Public Service, students from TAMU’s Bush School, as well as the Mays Business School and Department of Economics, participated.

Several students presented analyses of two recent transfer pricing cases, GlaxoSmithKline and Veritas. Comments on the presentations were provided by a practitioner panel moderated by Jana S. Lessne, KPMG LLP, Washington, D.C., and (photo right) Richard Lilley, PwC, Arlington, VA. Panelists included Stephanie Willis, Ernst & Young, Houston, TX; Juliana Marques, Baker & McKenzie LLP, San Francisco, CA; John Hughes, Senior Manager, Group 7, IRS APMA Program, Washington, D.C.; and Gene Tien, Baker & McKenzie Consulting LLC, Palo Alto, CA. The students also attended the TP Committee’s Texas Tax Directors Roundtable on new developments in transfer pricing, chaired by Kelly Hales (Ernst & Young), and were guests at the Tax Section Welcome reception.

Student presenters (pictured below) from the Bush School included Zike Chen, Andrea Berrios, Sean Larsen, and Chris Janes. Also presenting were (pictured below) Lindsey Cude, a master’s student in the Department of Finance, and Yue Zhang, a Ph.D. candidate in the Department of Economics. Other student guests included Heri Fano, Shuting Shan, Tetania Zakrevska, Yukuai He, Fatima Riyaz, June Nguyen, Nick Jiang, Parsa Pourankooh, and Sanmita Nepal.
FELLOWSHIP ANNOUNCEMENTS

2015–2016
Nolan Fellows

The Section of Taxation announced the recipients of the 2015 John S. Nolan Fellowships during its Midyear Meeting in Houston this past January. Named for the late John Nolan, Nolan Fellows are young tax lawyers who are actively involved in the Section and have demonstrated leadership qualities.

The six 2015–2016 Nolan Fellows are:

Jairo G. Cano
Agostino & Associates
Hackensack, NJ

Philip Hirschfeld
Ruchelman
New York, NY

Timothy J. Leska
Pepper Hamilton
Philadelphia, PA

Shawn McIntire
Donelson Barry
Broomfield, CO

Laura R. Westfall
King & Spalding
New York, NY

Diane Mehany
Caplin & Drysdale
Washington, DC

“After careful consideration, we are proud to recognize these young lawyers as our Nolan Fellows for the coming year,” said Armando Gomez, Chair of the Section of Taxation. “These lawyers have been actively committed to the Section and its goal of improving the tax system. With so many young and diverse lawyers joining the Section’s leadership, I am confident in the Section’s continued growth and success.”

Each one-year fellowship includes the waiver of meeting registration fees and assistance with travel to Section meetings. For more information about the Nolan Fellows program, visit the Section website, http://www.americanbar.org/groups/taxation/awards/nolans.html.

2015–2017
Christine A. Brunswick Public Service Fellows

The recipients of the Section of Taxation’s 2015–2017 Christine A. Brunswick Public Service Fellowships are:

• Frank DiPietro, a recent graduate of the University of Minnesota Law School, will be working with Mid-Minnesota Legal Aid to provide direct services to immigrants seeking to become compliant with the U.S. tax obligations along their path to U.S. citizenship. Frank will also provide tax assistance to veterans in the Minnesota area through the Minnesota Assistance Council for Veterans.

• Daniel Knudsen, scheduled to graduate from the University of Montana Law School in May, will be working with Oklahoma Indian Legal Services to provide tax advocacy and representation to Native American tribal governments and individual tribal taxpayers.

The Section’s Public Service Fellowship program was developed in 2008 to address the need for tax legal assistance and to foster an interest in tax-related public service. In 2013, the program was renamed the Christine A. Brunswick Public Service Fellowship in honor of the late Christine Brunswick, the Section’s Executive Director for over 25 years. Christine was a strong proponent of advancing pro bono public service efforts on behalf of underserved taxpayers and fostering a fair and equitable tax system. Under her leadership, the Tax Section devoted significant resources to further that goal.

The Fellowships provide funding for the Fellows’ salaries and benefits, as well as law school debt assistance, by means of charitable contributions to the sponsoring organizations. All applications are reviewed, and the successful applicants selected, by the Section’s Public Service Fellowship Committee. The Section awards as many as two Fellowships each year. For more information about the program, visit the website at www.americanbar.org/groups/taxation/awards/psfellowship.html. ■
REPORT OF THE NOMINATING COMMITTEE

2015–2016 Nominees

In accordance with Sections 4.2, 6.1, and 6.3 of the Section of Taxation Bylaws, the following nominations have been submitted by the Nominating Committee for terms beginning at the conclusion of the 2015 Annual Meeting in August. Under the Section Bylaws, the current Chair-Elect, George C. Howell, III of Richmond, VA, becomes Chair of the Section at the close of the ABA Annual Meeting.

Chair-Elect:
William H. Caudill, Houston, TX

Vice Chairs:
Charles P. Rettig, Beverly Hills, CA (Administration)
Thomas J. Callahan, Cleveland, OH (Committee Operations)
Joan C. Arnold, Philadelphia, PA (CLE)
Peter H. Blessing, New York, NY (Government Relations)
C. Wells Hall, III, Charlotte, NC (Pro Bono and Outreach)
Julie A. Divola, San Francisco, CA (Publications)

Secretary: Catherine B. Engell, New York, NY
(For a one-year term)

Assistant Secretary: Katherine E. David, San Antonio, TX
(For a one-year term)

Council Directors:
John F. Bergner, Dallas TX (For a three-year term)
Thomas D. Greenaway, Boston, MA
Roberta Mann, Eugene, OR
Carol P. Tello, Washington, DC
Gary Wilcox, Washington, DC

Give Back However You Can

Rule 6.1 also encourages lawyers to provide financial support to organizations that provide legal services to persons of limited means. There are worthy organizations in practically every community. If you have not already made a pledge, please consider supporting the Tax Section’s Tax Assistance Public Service (TAPS) endowment, through the ABA Fund for Justice and Education (http://www.americanbar.org/groups/taxation/taps_endowment.html). We hope to raise $2.5 million over the next five years for the TAPS fund, and I am pleased to report that all of the Tax Section’s Officers and Council directors have made contributions or pledges to help reach that goal.

Each of us has a responsibility to give back to the tax system. Please do your part by getting involved in pro bono work, volunteering to help the Tax Section, and supporting the TAPS fund.
Section CLE Calendar

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<td>May 15, 2015</td>
<td>Long-Term Disability Benefits Advanced Seminar Chicago, IL</td>
<td>ABA JCEB [<a href="http://www.americanbar.org/jceb">www.americanbar.org/jceb</a> 202.662.8670]</td>
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<td>September 17–19, 2015</td>
<td>Joint Fall CLE Meeting Sheraton Hotel &amp; Towers – Chicago, IL</td>
<td>Tax Section [<a href="http://www.americanbar.org/tax">www.americanbar.org/tax</a> 202.662.8670]</td>
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Section CLE Products

Listen at your convenience to high-quality tax law CLE on a variety of topics. Recordings and course materials from the following recent Tax Section webinars and more are available through the ABA Webstore. For more information and to purchase, visit [www.shopABA.org](http://www.shopABA.org) and search under CLE Products by program title or product code.

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<td>What’s a Young Tax Attorney to Do When...? (4/8/15)</td>
<td>CETX1504W1UMB</td>
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<td>Bitcoins: What You Need to Know About Virtual Currency (3/25/15)</td>
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<td>Update on State Taxation of Tribal Leased Lands: The New Leasing Regulations (2/25/15)</td>
<td>CETX1502W1UMB</td>
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<td>Going Out on Your Own and Changing Firms: Practical and Ethical Considerations (2/18/15)</td>
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<td>Kicking It Upstairs: How to Elevate Issues Within the IRS (1/14/2015)</td>
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<td>Back to Basics on the Ethics of Federal Tax Practice: Best Practices 101 (1/17/15)</td>
<td>CETX1501W1UMB</td>
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<td>Tax Opinions 3.07 Ethical Considerations and Best Practices Under the New Circular 230 Rules (12/10/14)</td>
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<td>The Tax Consequences of the Legalization of Marijuana (11/19/14)</td>
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<tr>
<td>Inversions: New Rules, Continued Challenges (11/12/14)</td>
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2015 MAY MEETING

The Section of Taxation thanks the sponsors of the 2015 May Meeting for their generous support.
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The NewsQuarterly Is Going Digital!

The Tax Section is excited to announce that the NewsQuarterly (NQ) will be moving soon to a digital-only format. Beginning with the Fall 2015 issue, the NQ will be available on the Section’s website at http://www.americanbar.org/groups/taxation/publications/newsquarterly_home.html, and, as in the past, the link to a downloadable version will be distributed by e-mail to Section members.

The digital NQ will continue to offer Section news and feature other interviews and articles of interest to our members, but the digital-only format will give us greater flexibility to engage members in new ways. Over time, we hope to enhance the existing features to make them more user-friendly and to add new features with increased coverage of the Section’s areas of practice and committee activities. In addition, by eliminating the paper version, the NQ digital-only format will shrink the Section’s environmental footprint. As we continue to work toward the fall roll-out of the new NQ, the NQ Editors invite your ideas, article submissions, letters to the editor, and other inquiries. Please contact us at tax@americanbar.org.

If you want to receive the NQ by e-mail, please be sure that the Section has the correct e-mail address for you and that your ABA communication preferences reflect your wish to receive the NQ by e-mail. You can call the ABA Service Center at 800-285-2221 or go to www.myABA.org to register your e-mail. The ABA values your privacy: we do not share or otherwise distribute our member e-mail addresses outside the ABA.