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EDITORIAL POLICY

ABA Tax Times (ATT) is published at least four times a year featuring articles covering a wide range of tax topics and areas of tax practice, interviews with diverse tax practitioners, Committee reports, Tax Section comment submissions to the government, and other news and information of professional interest to Tax Section members and other readers.

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FROM THE CHAIR

Boston Meeting Successes, and More to Come

By William H. Caudill, Norton Rose Fulbright LLP, Houston, TX

We had a great joint meeting in Boston with the Real Property, Trust and Estate Law Section at the end of September. There were approximately 1,100 in attendance, and I was inspired by the enthusiasm about the activities of the Tax Section for the coming year. We have a lot of work to do, and we are going to have a good time doing it.

Exciting Developments

Our friends in government appeared in strength at many of our Committee meetings, with 106 government and judicial personnel in attendance (including 92 speakers). At the Partnerships and LLCs Committee, Ossie Borosh, Senior Counsel, Office of Tax Legislative Counsel, reported that the regulations under sections 707 and 752 were released on the day of the meeting and described the contents of the new regulations. This was an exciting announcement, leading to a number of thought-provoking questions about the workings of the new regulations. The presentation demonstrated the high standards for Tax Section meetings. Similarly, at the Corporate Tax Committee, Kevin Jacobs, Senior Technician Reviewer, Office of Associate Chief Counsel (Corporate), and Filiz Serbes, Branch Chief, Associate Chief Counsel (Corporate), reported that the regulations under section 385 had been sent to the Office of Management and Budget for final review, and they described the contents of the new regulations in general terms. Again, the government speakers responded to many questions from attendees, providing an excellent introduction to these new developments for corporate tax practitioners. The regulations were released not long after the meeting on October 13, 2016, and were published in the Federal Register on October 21, 2016.

Cathy Hughes, Attorney-Advisor, Office of Tax Legislative Counsel, addressed our group about the proposed section 2704 regulations. She noted that the proposed regulations have been misconstrued. The effect of disregarding a disregarded restriction is not intended to be as pervasive as indicated in the comment criticisms.

At the Plenary Session, Barbara Angus, Chief Tax Counsel, House Committee on Ways and Means, reported on the Committee’s ambitious plans to reform the Tax Code with a goal of making the country’s businesses more competitive. These plans, described as “A Better Way,” were released by the House Republicans this past June as a blueprint for lowering individual and corporate rates, lowering capital gains rates, and creating a border adjustable, international business tax system.
Committee Programs and Law Improvement Programs

In addition to the exciting developments described above, our Committees conducted consistently excellent programs at the Boston meeting—some 153 separate offerings! Clearly, these programs are valuable benefits for our members.

We also have been busy on the law improvement front. In response to a request from the House Committee on Small Business, the Administrative Practice Committee, through their chair, George Hani, organized informational testimony about the impact of Internal Revenue Service examinations on small businesses. Jennifer Breen, one of the Committee’s vice chairs, presented the testimony and appeared with Julian Kim (Vice-Chair, Government Relations) and Sheri Dillon (Council Director) at the hearings on behalf of the Section. You can read the written testimony and also view a video clip on our website.

We have six technical comment projects in development, and there are seven more under discussion. I look forward to seeing these projects progress.

Each Committee is urged to undertake at least one law improvement or government submission project per year. Please be on the lookout for appropriate comment projects and, even better, volunteer to assist in developing a Section response to a request for comments.

New Diversity Requirements

As I mentioned in my last column and in my remarks at the Plenary Session in Boston, the ABA Board of Governors has approved a new policy requiring speaker diversity in all ABA-sponsored CLE programs that involve three or more speakers. For programs with three or four speakers, there must be at least one diverse speaker. For programs with five to eight speakers, there must be two diverse speakers. For programs with nine or more, there must be three. If the program does not comply, CLE credit will be denied.

These requirements are not effective until March 1, 2017, but we should begin our work to comply, panel by panel, as soon as possible. The Tax Section has done well in achieving our diversity goals, with about 38% diverse representation on our panels, in the aggregate, at our meeting last May. The focal point for this compliance effort will be our Committee Chairs as they formulate plans for the upcoming meetings. The Committee Chairs will then work with Scott Michel (Vice-Chair, Committee Operations) to ensure technical compliance with the ABA’s new diversity requirements as well as with the Section’s diversity guidelines which also embrace diversity in firm representation, geography, and age. Please contact either me, Scott Michel, Joan Arnold (Vice-Chair, CLE), or Ty Hansen (the Section’s Acting Director) with any questions about this effort.

Pro Bono and Public Service

The Section has a number of successful pro bono and public service programs born out of a commitment to pro bono and public service that dates back many decades. Every year since 2009, we have funded two recent law school graduates (Brunswick Fellows) for two-year Public Service Fellowships designed to provide representation for low-income taxpayer communities. The Section also participates in the Tax Court Calendar Call, Volunteer Income Tax Assistance, and Adopt-A-Base programs. All of us have an obligation to give back to the tax system, and participation in one or more of these Tax Section programs is a great way to do that.
Funding is required to support these programs. As described later, the Section currently is dealing with significant budget issues. Without additional funding, the Council must continually reassess these programs as part of the process of reconciling budgetary and programming needs.

The Tax Assistance Public Service (TAPS) endowment has been established to address funding issues, make permanent the Brunswick Public Service Fellowship program, and remove the program from the vicissitudes of the Section's budget.

The TAPS endowment received an initial contribution of $2.5 million from the Section's reserves. The endowment has an additional fund-raising goal of $2.5 million for a total of $5 million, the income from which is designed to support the Brunswick Fellows for the foreseeable future.

Approximately $425,000 of the additional $2.5 million has been raised, but there remains much to do to raise the remaining target over the next three years. All of the Section's officers have made commitments, but we need broader support. I encourage each of you to make your own commitment to the TAPS effort and show your support for the Section's efforts to provide assistance to the underserved. The blue ribbon on your Section Meeting name badge shows that you have made a commitment. I look forward to seeing many more blue ribbons at future Section Meetings.

**Member Recruitment**

As **ABA President** Linda Klein has emphasized, new member recruitment is Job One. The Tax Section is a great value proposition, both from the standpoint of national technical tax information and networking opportunities. Please make an effort to recruit one or two new members this year and tell them about the rewards of membership in the Section.

This year, the ABA has introduced a new membership program where LL.M. students (in addition to regular J.D. students) will be allowed to join without paying dues, so long as they are students. In addition, if a student enrolls as a premium member (only $25), that student is offered a $250 discount on the BAR/BRI review course. More details are available at [www.abaforlawstudents.com](http://www.abaforlawstudents.com).

**Law Student Tax Challenge**

Speaking of law students, in September the Section kicked off the 16th Annual Law Student Tax Challenge (LSTC), and as I am writing this, many J.D. and LL.M. teams are scrambling to prepare their materials to meet the LSTC's critical November deadline. This highly popular competition, conceived and organized by our Young Lawyers Forum (YLF), is a great way for law students to showcase their knowledge and gain valuable exposure to the tax law community. On average, more than 60 two-person teams compete in the J.D. Division and more than 40 two-person teams compete in the LL.M. Division. Many of our past winners move on to become active in the Section. For example, one such winner, Anne-Marie Rabago, is featured in the Interview section in this issue of ABA Tax Times.

Based on the written work product, which is due November 4, six teams from the J.D. Division and four teams from the LL.M. Division will be selected to receive a free trip (including airfare and accommodations for two nights) to the Section's 2017 Midyear Meeting this January. Each team will defend its submission before a panel of judges, including some of the Section's most experienced tax practitioners, Tax Court judges, and other prominent government officials. This is truly a great opportunity for members to participate as judges. In the past several years, I have truly enjoyed teaming with several of our YLF members, senior representatives of the Internal Revenue Service, including Deborah Butler (former Associate Chief Counsel),
Bill Paul (past Section Chair and current Deputy Chief Counsel), and Karen Hawkins (former OPR Director and current Chair-Elect of the Section) and several Tax Court judges (including Judges Cohen, Marvel, Panuthos, and Wherry). Please consider volunteering to serve as a judge and taking advantage of this opportunity to engage with the LSTC law student competitors who have demonstrated a real interest in tax. They are the future of our profession.

**Budget Deficit**

One critical issue that our Immediate Past Chair, George Howell, mentioned in his last column and I mentioned in my first column is our Section’s current budget deficit. Our expenses have been just about the same over the past three years, but our revenues have declined due to reduced membership, reduced corporate sponsors, and reduced external CLE revenues. Your Section officers, Council directors, and Section staff will be reviewing every significant expenditure and revenue item to reconcile the deficit.

Items we have already addressed include the Companion Events and the Companion Breakfasts offered at Section Meetings. Due to minimal participation and growing, excessive costs, these items have been discontinued. In lieu of the Section-sponsored companion activities, our Section Meeting staff will coordinate with any companions interested in local sightseeing activities (several longstanding companions will also assist), and all companions with a name badge will be allowed access to our regular Hospitality area for breakfast.

The first-time attendees’ dinners at Section Meetings, likewise, have become costly and poorly attended. We have eliminated this event, but we will be redoubling efforts to make first-time attendees feel included at the meeting, beginning with the complimentary Welcome Reception on Thursday evening.

The Section Reception on Friday evening has also seen significant increases in costs and declines in attendance (even with the $80 ticket charge, the cost to the Section is two and one-half times the ticket price). It will be discontinued for the Midyear Meeting in January. Instead, it is being considered to extend the Young Lawyers/Diversity Reception (a complimentary event) for all until 7:30 p.m. to underscore the Section’s interest in providing more inclusive yet budget-friendly events that all attendees can enjoy. Continuing developments on this will be reported.

On the revenue side, it is worth noting that we have not raised Section meeting registration fees since 2012, despite increasing costs. Council, therefore, voted to increase meeting registration fees for Section Member, non-Section Member and non-ABA attendees, beginning with the 2017 Midyear Meeting in Orlando. Section Meeting fees for young lawyers, academics, and public-sector attendees, however, have not been raised.

Similarly, Section dues have not been raised in four years. Council approved an increase to $75, effective in September 2017.

The Section is committed to providing full value for your membership, and we welcome your comments as we work through this process. I will use my column in ATT to continue to keep you informed as our budgetary issues are addressed.

**Unsung Heroes**

At the Boston meeting, I noted in my remarks to the Plenary Session that many of our Section officers, Council directors, and Committee officers are recognized, from time to time, for their hard work, such as fine
tax lawyers like Terry Cuff from Partnerships and LLCs, and Mark Silverman and Bob Wellen from Corporate Tax. There are, of course, many active members in our Section that also deserve to be recognized.

Two that I commended from the podium at the Boston meeting were Jordan Weiss of Los Angeles, California, who has participated for many years with the Partnerships and LLCs Committee and served as Vice Chair of the former Committee on Business Cooperatives and Agriculture, and Prof. Bill Lyons, formerly of Lincoln, Nebraska, and now of Castine, Maine, who has served since 2007 as Associate Editor-in-Chief of The Tax Lawyer.

If there are others that you believe should be recognized, I hope you will let us know. The Section would not be what it is today without the efforts of its many unsung heroes.

Orlando

We are looking forward to the Midyear Meeting, which will be held January 19-21, 2017, at the Hilton Bonnet Creek and Waldorf Astoria in Orlando, Florida.

Due to a scheduling conflict that none of us could have predicted would become the culminating event of a highly unusual election year, our nation’s Presidential Inauguration will take place during the Midyear Meeting on Friday, January 20, 2017. We are working with the hotel to accommodate meeting attendees who may wish to follow the Inauguration Day events. In any event, for those interested in the outcome of the election, the conversation at the meeting is certain to be lively. I look forward to seeing you there!

In my first months as Chair, I have enjoyed getting to know the Section staff more closely. I would be remiss in closing if I did not recognize their many efforts on behalf of the Section and, in particular, the many contributions of Ty Hansen, as our Acting Executive Director.
PEOPLE IN TAX

Interview with Anne-Marie Rabago

By Tom Greenaway, KPMG LLP, Boston, MA

Anne-Marie Rábago recently joined the State Bar of Texas as Director of the Texas Opportunity & Justice Incubator in Austin. At the time of this interview, she served as Director of the Access to Law Incubator and an Adjunct Professor of Tax at California Western School of Law in San Diego. She is a former Chair of the Young Lawyers Forum. We interviewed her at the Joint Fall Meeting in Boston to talk about the incubator movement and the access to justice gap.

Q How did you get involved in the Section?

A I entered the LL.M. Division of the Law Student Tax Challenge back in the fall of 2007, and I ended up being one of the finalists invited to Henderson, Nevada for the Midyear Meeting.

Q Lake Las Vegas.

A Lake Las Vegas! My partner and I competed. We were the first—and at that meeting, the only team from Northwestern—to compete. And I think we went up against three teams from Denver, who were fairly consistently at the top of the LL.M. Division competition up to that point. Gary Scanlon and I won first place, and we both have been pretty involved with the Section ever since. Northwestern loves to have their LL.M.s compete and generally ends up with a team or two in the finals. And they really enjoy that legacy. At this point, they sponsor different events, different Section meetings each year.

Q So after the LL.M., you graduated. Tell me what you did for practice after you left the LL.M. program.

A My husband and I decided that we wanted to return to Dallas, Texas, which is where we had met and lived previously. I applied for positions in Dallas and ended up working for PwC in their International Tax Services as a Senior Associate. They were a pretty heavy CPA practice group there in Dallas, and since I was the only lawyer on the team I got all of the meaty research and writing jobs. Actually, it was fascinating work. Intellectually, it was really interesting: the clients they had and the work that they were doing, including lots of restructuring projects, headquarters studies, transfer pricing, and so forth.

But a few things happened simultaneously. One was that my husband and I realized we had been a little too hasty wanting to go back to Dallas. We agreed one morning that we wanted to return to San Diego.
which is where we had lived early in our relationship, and where I had gone to law school. He also wanted to change careers and go back to school. This was very early 2009, and the economy was really just in the tank. I went to the leadership at PwC and asked if there was any way that I could get to San Diego with PwC. My partner called and the practice group there said that they actually had been reducing their size in San Diego and recently had to send some managers and seniors to Los Angeles in order for them to be able to keep jobs, so there wasn’t any place for me.

That was okay because when I thought about what I was doing from a work perspective—this sounds so hokey—but the reason I went to law school was because I wanted to help people. The work I was doing with the accounting firm didn’t have a clear line of sight for me relative to how I was helping people with my knowledge and my time and my work. So I decided that if we were going back to San Diego, I was going to start my own practice, and I was going to really be able to see the impact that I was making with individuals and small businesses.

Of course, there was this little bar exam—the California bar exam—that I had to pass and get out of the way before I could actually hang my shingle out. Although I guess I probably could have practiced federal tax. But in California, most people with federal tax issues come with state issues at the same time.

Q  So you got the bar out of the way, and then hung out your shingle. How did that go, in the depths of the recession?

A  Actually, there was plenty of business. It was just a matter of getting out and letting people know that you existed, so they would start sending clients your way. As an attorney, everyone just assumes you know all laws, all things about all laws. I built this pretty significant referral network of other attorneys that do not practice tax law (as well as some that did) who are friends and colleagues. We’d refer work to each other. Non-tax attorneys, you know, were really the bread and butter of my business in terms of referrals.

Q  And how about the Section? You stayed connected with the Section through all this?

A  Yes. Initially, I was asked to do some panels. Kelley Miller invited me to do a Tax Bridge to Practice panel about solo practice. So I did that. Then the next year I came back and did another Tax Bridge panel on social media and tax practice. I had been involved with the Law Student Tax Challenge, so I was on the Marketing Committee for the Law Student Tax Challenge, then the Written Round Judging Committee. Then I served as the Chair of the Written Round Committee and then I was Co-Chair of the Law Student Tax Challenge. Two years of that. And then at the same time, Melissa Wiley and Ivan Golden invited me to be a Vice Chair of the Young Lawyers Forum (YLF).

Q  Let me ask about the connection, if any, between the Section and what you were doing in terms of getting your practice off the ground.

A  Well, when you’re a solo practitioner, it becomes important to establish your credibility. I always felt that my involvement with the Section and speaking on panels were things that I would put into online profiles and my resume. I’d talk about my involvement. It’s a national organization; so, as a tax attorney, I feel like it lends credibility. My involvement with the Section says this person takes their continuing education seriously. Being a speaker helps to establish expertise. In my role now, I try to get my new attorneys to get involved in speaking opportunities as early and as quickly as possible because it’s just another point of social proof, which is what we call it in the marketing world. Other people listen to this person, so maybe I should listen to this person as well.
Q So what is your current role?

A After almost six years of running my solo practice, I was invited to take over the reins of a solo practice incubator program at my alma mater, California Western School of Law, which is an ABA-accredited school in downtown San Diego. Our program was founded by a visiting professor in 2012. At that time the incubator program at California Western was the very first incubator in California, the very first legal incubator on the West Coast, and about the fifth or sixth program in the entire country.

Q What is an incubator?

A The incubator movement—we consider it a movement—was born out of a triple need in the legal industry. One, we still have issues with new lawyers who graduate from law school but find there are no job opportunities for them. They face the decision of “do I practice law at all?” or “do I have to go and do something outside of law?” Second, as lawyers, we can hang out a shingle immediately and try to make a go of having our own law practices. But the challenge with doing that is many young lawyers don’t know how to own a business, and they don’t have the first idea of how to get a client. And maybe they know how to service their clients’ legal needs, but they are not even 100% confident that they know that either. And then third, inside of the incubator movement we see a significant access to justice gap.

Q What is the access to justice gap?

A We have legal service organizations who take government funding and, because of that, the government generally requires that the clients served by these legal service organizations meet certain income guidelines or caps on how much the clients that they serve make for a living. Market attorney rates, which in San Diego average $300 an hour, are expensive. That leaves a significant chunk of the population who either determine attorneys are unaffordable or who go to legal aid and are turned away—or both. These people may feel the law is not something that is there to serve or protect them.

And so one of the things we teach attorneys in these incubator programs across the country are alternative legal service delivery models, concepts of unbundled services, something other than full representation. Some of the programs out there use a sliding fee scale, based on income. People who do this often just publish the scale. If your household has this many people, your income is within this range, our hourly rate will be $X per hour. The hourly rates are generally significantly below market, and depend on what the client can afford.

Q And so how’s the incubator program going in San Diego?

A It’s going well! I have 14 attorneys in my program. The program lasts anywhere from 12 to 24 months, the idea being they come into the program, they make use of the tools and the training, and then they fly free from the nest with sustainable practices that they can continue to use to build and fend for themselves. One of the ways we make this possible for young attorneys is that the program provides them with tools, training, and also the ability to launch their practices with extremely low overhead. There are more than 60 programs like this across the country now.
I have 14 attorneys in two spaces in downtown San Diego, both in class A office buildings. My attorneys share a room. They each have an individual desk in that room, with a file drawer and chair. And they bring in their own equipment, technology, printers, computers, etc. Their desk costs $250, $300 a month, depending on the location. Other than the law license, the only other financial outlay they’re required to have is malpractice insurance. The only financial outlay they’re required to make other than for the law license is for malpractice insurance. In California we have a wonderful insurance company: for a new solo, the first year’s insurance rates are $500 for the whole year.

Q That’s great!

A And you can finance that and it ends up being about $50 a month. But even at that $300 to $350 a month overhead outlay, there are young attorneys who will say, “I can’t. I can’t spend that without knowing that something’s coming through the door because in addition to overhead, I also have my rent, my meals, my family.” So it’s a significant hurdle, even with that low overhead price tag and being able to get the support and training needed to start their own practices. It takes a pretty big leap of confidence to come into an incubator program.

Q What's the typical exit strategy? Is there any kind of pattern that you see with attorneys leaving incubator programs?

A Well, by nature they’re designed with a consistent flow of attorneys coming in and leaving. Most programs run no more than two years, to allow their attorneys to get all of their ducks in a row and feel also that they’re ready to go out into the market.

Q What other benefits do incubators provide?

A While they’re in the program, attorneys receive LexisNexis Advance for free. While they’re in the program they receive CLIO Practice Management software free. They get access to free CLEs from all kinds of different angles. In California we have Continuing Education of the Bar (CEB), which is a joint continuing education program of the University of California and the State Bar of California. There’s also PLI, which is the Practical Law Institute. A number of these national organizations and vendors have come on board to say you’re doing good things for the community and we’re going to reward that by helping to underwrite, if you will, your ability to start this law practice. Because the idea is that, in some capacity, they’ll continue to serve this market with affordable legal services now that they understand how to do that.

Q But does that happen, in your experience? Do your alumni continue to serve the affordable legal services market?

A My program, as I said, has been around since 2012. At this point I have about 30 graduates, alumni of the program, and I had to pull these statistics together this past March for a survey, which the ABA Standing Committee on the Delivery of Legal Services organization put together. They surveyed all of the incubators across the country. They had about 46 of us that actually fully responded to the surveys. One of the things they asked about is “Do you have graduates of your program? If so, what are they doing now?” So I have about 30 graduates. What I gleaned from looking into all of them is that about half have stayed in their solo practices. That is, there are about 15 of them who used the program to launch their solo practices and still do the work that they did while they were in the incubators. Now, they probably have a little bit more of a mix of full service, full price clients, but they still have a commitment to pro bono work.
and to serving the access to justice gap. The ones who didn’t stay in solo practice, from my perspective, I don’t see as a failure of the program. I think that any time that you have an opportunity to try something you think you might want to do but you learn that actually you do not want to do, that’s a win from a career perspective.

The ABA Standing Committee on Delivery of Legal Services is very involved with the incubator movement across the country, and it has provided us with a lot of support services and helped to build bridges between the programs. We’re all out here doing similar things, so the committee helps us figure out how can we can take tools and share those resources amongst ourselves.

Q  So let’s talk a little bit more about this access to justice gap and whether or not you think the incubator program is making a dent in your community and nationwide.

A  Honestly, I walk away from my office every day thinking, what more can we do? How can we bridge this gap? Because it’s overwhelming. And I think that we are starting to chip away at the problem, and it’s progress, but it’s not enough. It’s not enough.

Q  What more do you think tax attorneys could do?

A  Well, one, I don’t think most tax attorneys are doing any of this. I don’t have any tax attorneys in my incubator. We just held a panel yesterday and so I put out a call on this (we have a listserv of people who lead incubators) to say, “Does anybody have a tax attorney in their incubator program?” So my panel had a gentleman who runs a program here in Boston and he said, “You know, we do get clients who call, but not a whole lot, for tax.”

And so I think that just an awareness among tax attorneys that this is something they could do would help. I know from my own practice that the access to justice gap exists in tax law. It exists both from the side of planning as well as, maybe more severely, on the side of controversy. And our low-income taxpayer clinics are wonderful. I volunteer for one in San Diego. These programs have been around a while, but they, too, are subject to income restrictions. I think the grant they receive from the IRS says that 90% of the clients they serve must fall within 250% of the federal poverty guidelines. That’s a very low threshold.

When I was practicing, I would have clients call whose income suggested that they really couldn’t afford what I would like to charge them. I would say “Call Legal Aid and the University of San Diego LITC as well. Call those two programs. Do their intake, see if they will take you as a client with your income and your needs.” And invariably they’d call me back and say, “No, I don’t qualify.” Then, as a practitioner trying to run my practice, I had to make that call. Was I going to help this person who obviously had a need and do it at some lower rate or some really stretched out payment plan? But I wasn’t trained on how to build a practice that offers limited scope services, sliding scale fees. So that’s valuable training we provide for these attorneys that are in these programs, in addition to the low overhead.

Often I would take the cases and then run into a client collection problem. And it’s hard. It’s a significant challenge when you’re in private practice, trying to make a living yourself. It’s no wonder that taxpayers, in general, just believe that representation before the tax agencies isn’t something that’s within their grasp.

Judge Holmes was in San Diego and talked to the Tax Section of the San Diego County Bar Association in May. He told us that 90% of the S cases and 60% of regular cases are filed by taxpayers pro se, representing themselves, for something like a total of 14,000 cases last year. Based on what the Tax Court had studied,
most tax attorneys would require a $7,500 to $10,000 retainer in order to even begin to crack open a case that was worth $50,000 to the taxpayer. So you spend $7,500 to $10,000 in order to fight a potential $50,000 tax deficiency. Do the math on that; it doesn't make sense.

So it has to come from outreach and awareness for the taxpayers that there may be alternatives that are affordable for them, and then we have to build alternatives that are affordable for the taxpayers. I think there probably are more tax attorneys out there that would be interested in doing this than anybody's aware of.

Q Do you have a plan, a way to connect tax lawyers in general with incubators or with clinics?

A It’s hard. I think conversations like this and panels like the one yesterday are a place to start. Reaching out to LL.M. programs and the law schools that have more significant tax offerings in their J.D. programs is also important. There's a movement for nonprofit law firms as well.

Q Is there such a thing as a nonprofit law firm?

A Oh, yes, those exist. The one that is most recognized in this country is in Utah. It's called Open Legal Services. Their website is: openlegalservices.org. They're a 501(c)(3) organization, and their founders are attorney employees. Unless they've changed this recently, they only do family law and criminal law. These are all just models, innovative ways of trying to disrupt the system, the legal industry, as it has always existed and as it stands. But the nonprofit law firm model is one that could be taken and, I think, applied to most any practice area. Not all, but many.

Q There’s no reason why it couldn’t be applied to tax.

A I think there’s huge need and opportunity. It’s just going to take some awareness and some people taking the reins and building it. As I said, I’ve only been in this role for the last year and a half, so I’ve just been absorbing everything I’ve heard and trying to learn as much as I can. And, you know, I’d be open to conversations and help in trying to build something.

Q What can Section members do to help you out?

A Right now, I’d recommend visiting the Lawyer Incubator Directory on the ABA Standing Committee on the Delivery of Legal Services webpage (http://www.americanbar.org/groups/delivery_legal_services/initiatives_awards/program_main/program_directory.html) to locate a program in your area. Consider sending low-income and modest-means referrals to your local incubator lawyers and volunteering as a mentor for young attorneys in your local incubator program.

As I look toward the future, I believe it's important that we continue to have these conversations. It would be great to get people on board who understand, are sympathetic, and see this access to justice need. Then, let's see what kinds of programs we can create in the tax law community to address the need. ■
AT COURT

Implications of Bitcoin Not Being Actual Currency: The Espinoza Case

By Joni Larson, Professor, Indiana Tech Law School, Fort Wayne, IN

Bitcoin is virtual money held in a virtual account.1 There is no central bank or clearing-house or other third-party administrator. Rather, transactions are peer-to-peer, made directly between sender and receiver. Users download software onto their computers or smart phones to create a “wallet”2 and use the wallet to send and receive bitcoin. The payor sends a “public key” that gives the receiver ownership rights. He certifies the transaction by signing with his “private key.”

There is no entity that issues bitcoin. Rather, new bitcoins enter the system through “mining.” The verification and reconciliation of bitcoin transactions requires solving increasingly complex mathematical problems. “Miners” provide the computing power needed to complete the task and receive newly-created bitcoins as payment for their services.3 Currently-existing bitcoins can be obtained either by receiving them as a payment or gift or through an exchange that allows users to convert cash to bitcoins and vice versa by matching buyers and sellers.4

There is a finite number of bitcoins available, about 21 million when all are mined. The program’s designer projected that number to be reached in 2140.5 As part of this finite system, each bitcoin has its own private digital fingerprint that cannot be used again after it has been activated.

The value of a bitcoin is not tied to the value of the dollar or any other currency but rather fluctuates based on the market. Because the bitcoin system maintains daily historical pricing information, purchase and sale prices can be easily tracked.6

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1 Satoshi Nakamoto”, not his real name, posted papers online laying out the structure of bitcoin, a virtual currency. See Bitcoin: A Peer-to-Peer Electronic Cash System, bitcoin.org; Frequently Asked Questions: How Does Bitcoin Work?, bitcoin.org. A few months later, bitcoin was an operating currency with a market capitalization in excess of $5 million. For information on cryptocurrency market capitalization, see Crypto-Currency Market Capitalizations.
2 Users may own as many wallets as they want.
3 “To perform the work of mining, bitcoin miners download free bitcoin software that they use to solve complex equations. These equations serve to verify the validity of bitcoin transactions by grouping several transactions into a block and mathematically proving that the transactions occurred and do not represent double spending of a bitcoin. When a miner’s computer solves an equation, the bitcoin network accepts the block of transactions as valid and creates 25 new bitcoins and awards them to the successful miner.” U.S. Gov’t Accountability Off., GAO-13-516, Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks 6 (2013). See also Christopher Rajotte, Andrew Ittleman & Mitchell Fuerst, Bitcoin Taxation: Understanding IRS Notice 2014-21, Bitcoin Magazine (Apr. 4, 2014).
I. Concerns About Use of Bitcoin

Bitcoin is not the first virtual currency. It has, however, garnered the most attention by being embroiled in several scandals. With transfers made peer-to-peer, anonymously, encrypted, and without the use of an administrative clearing house, bitcoin has proven to be the currency of choice for those who want to purchase illegal goods or services anonymously.7 Probably the most well-known illegal activity involving bitcoin is Silk Road, an underground virtual marketplace involved in the online sale of illegal drugs and other unlawful goods and services. Ross Ulbricht, with an online presence as the “Dread Pirate Roberts,” operated the website. Sales were kept anonymous by using a special computer setup that concealed the identity of the users and using bitcoin to make purchases. Eventually the site was shut down and Ulbricht convicted of seven different crimes including distribution of narcotics, engaging in a continuing criminal activity, computer hacking, and conspiracy to commit money laundering.8

Bitcoin was Ulbricht’s choice of currency because the system is both anonymous and transparent. Transfers are anonymous in that they are recorded using user addresses. As long as a wallet address is not associated with the user, the user’s identity remains hidden. The system is transparent in that all transactions are recorded and stored publicly and permanently on the network in a “block chain.”9 Anyone with a computer can see the balance and transactions of a bitcoin address.10

II. Tax Implications of Bitcoin

For tax purposes, bitcoin is, in essence, nothing more than a medium used to carry out barter exchanges.11 Those who are paid in bitcoin for goods or services rendered have gross income.12 Compensation payments are subject to the same payroll tax withholding requirement for FICA and FUTA as other compensation payments,13 and the employer must satisfy the usual information reporting requirements.14

7 For a further discussion on the difficulties of regulating bitcoin and other virtual currencies, see Omri Y. Marian, supra n.8; Reuben Grinberg, Bitcoin: An Innovative Alternative Digital Currency, 4 HASTINGS SCI. & TECH. L.J. 160 (2011).
8 See United States v. Ulbricht, 31 F.Supp. 3d 540 (S.D.N.Y. 2014). See also Ross Ulbricht Convicted of Running Silk Road as Dread Pirate, Bloomberg Business News (Feb. 4, 2015). Bitcoin is not the only cryptocurrency used to carry out illegal activities. On May 23, 2013, the government brought an indictment against the operators of Liberty Reserve, a popular virtual currency, charging the operators with money laundering and operating an unlicensed money transmitting business. Indictment, at *14, 16, United States v. Liberty Reserve, 13 Crim. 368 (S.D.N.Y. May 23, 2013).
10 Dean Walsh, Digital Cash – A Beginner’s Guide to Anonymous Digital Currency, HUBPAGES (June 23, 2014); Some Things You Need to Know, BITCOIN.ORG; Roger Wu, Why We Accept Bitcoin, FORBES (February 13, 2014).
11 Notice 2014-21, 2014-16 I.R.B. 938, Sec. 4, Q/A 1. The notice applies to the federal tax consequences of transactions that use convertible virtual currency. See also Rajotte et al., Bitcoin Taxation, supra n. 4.
12 I.R.C. §61(a)(1), (3); Notice 2014-21, Sec. 4, Q/A 3. The taxpayer has the burden of establishing the fair market value of bitcoin received and will take a tax-cost basis. Notice 2014-21, Sec. 4, Q/A4. The fair market value of bitcoin can be determined by the exchange rate as listed on an exchange if “the exchange rate is established by market supply and demand.” Notice 2014-21, Sec. 4, Q/A 5. Because bitcoin maintains daily historical pricing, purchase and sale prices can be easily tracked.
13 Notice 2014-21, Sec. 4, Q/A 11.
14 Notice 2014-21, Sec. 4, Q/A 12, 13.
Those who “mine” bitcoins by using their own computer resources to validate bitcoin transactions receive compensation for services.\textsuperscript{15} That income is self-employment income, subject to self-employment tax.\textsuperscript{16}

Those who pay with (or otherwise dispose of) bitcoins have a disposition of property on which gain or loss generally must be recognized.\textsuperscript{17} As with all assets sold, the character of a gain depends on how a taxpayer held the bitcoins.\textsuperscript{18} For taxpayers who hold bitcoins as an investment, the character will be capital.\textsuperscript{19} Any net gain will be taxed at the preferential rates if held for more than one year,\textsuperscript{20} and the amount of net loss that can be recognized may be limited.\textsuperscript{21} If bitcoins are held by a taxpayer as inventory, any gain will be ordinary.\textsuperscript{22}

III. The Espinoza Case: Selling Bitcoin Does Not Mean the Seller Is a Criminal

In Miami Beach, a detective worked with a Special Agent from the United States Secret Service’s Miami Electronic Crimes Task Force to investigate the purchase and sale of bitcoins in South Florida. They began by visiting a peer-to-peer bitcoin exchange used by potential bitcoin sellers and buyers.\textsuperscript{23} They identified a seller who they thought might be engaged in illegal activity based on his user name, the fact he was available to make trades 24 hours a day, and that he wanted to make the trades in public locations.\textsuperscript{24}

The detective contacted the seller and arranged a meeting where he purchased 0.40322580 bitcoins for $500. The seller explained he made a profit by buying and selling bitcoins. He would buy at 10 percent below-market prices and sell at 5 percent above-market prices.\textsuperscript{25}

The detective arranged a second meeting at which he bought one bitcoin for $1,000. He also asked the seller if the seller would be willing to accept stolen credit card numbers as payment for bitcoin purchases. The seller was noncommittal.\textsuperscript{26} Through text message communication, the detective purchased another $500 in bitcoins.\textsuperscript{27}

The detective arranged a third meeting, this time in a hotel room where the detective told the seller he wanted to buy $30,000 in bitcoin. He showed the seller a wad of cash.\textsuperscript{28} The seller was nervous about

\textsuperscript{15} I.R.C. §61(a)(1); Notice 2014-21, Sec. 4, Q/A 8.
\textsuperscript{16} I.R.C. §1401; Notice 2014-21, Sec. 4, Q/A 9-10.
\textsuperscript{17} Any realized loss under section 1001(a) is recognized. Notice 2014-21, Sec. 4, Q/A 1, 6. Losses derived from transactions entered into for profit are generally allowed. I.R.C. §165(c)(2). If a bitcoin payment constitutes a business or investment expense, presumably the taxpayer can claim a deduction equal to the amount paid. I.R.C. §§ 162, 212. If the payment is a salary, the employer is required to withhold FICA and FUTA tax and file a Form W-2, the same as if the employee had been paid in cash. Notice 2014-21, Sec. 4, Q/A 11-14.
\textsuperscript{18} I.R.C. §1221(a); Notice 2014-21, Sec.4, Q/A 7.
\textsuperscript{19} Notice 2014-21, Sec. 4, Q/A 7; I.R.C. §1221. Bitcoin would fail to meet any of the exceptions in Section 1221(a).
\textsuperscript{20} I.R.C. §§1(h), 1222.
\textsuperscript{21} I.R.C. §1211(b); 1222.
\textsuperscript{22} I.R.C. §1221(a)(1); Sec. 4, Notice 2014-21, Q/A 7. In the hands of a taxpayer who is a “dealer” in that he in the business of buying and selling bitcoin, it will be characterized as an ordinary asset. Id.
\textsuperscript{23} https://localbitcoins.com.
\textsuperscript{24} Florida v. Espinoza, Order Granting Defendant’s Motion to Dismiss the Information, at *1-2 (F14-2923, 2016).
\textsuperscript{25} Id. at *2.
\textsuperscript{26} Id.
\textsuperscript{27} Id. at *2-3.
\textsuperscript{28} The detective’s cash was counterfeit. Id. at * 3.
accepting the cash and never took possession of it. During that meeting, the seller was arrested and charged with unlawfully engaging in a money services business\textsuperscript{29} and money laundering.\textsuperscript{30}

The seller-defendant filed a motion to dismiss the information. With respect to the charge of being unlawfully engaged in a money services business by being a money transmitter, the court easily determined that the charge did not fit the transaction. The seller was not receiving currency in order to transfer it to a third party; he did not act as a middleman. That type of service more closely resembled the services offered by businesses like Western Union. Rather, the court concluded seller-defendant was more akin to a day trader, buying low and selling high to make a profit on bitcoin transactions.\textsuperscript{31}

The government then alleged the defendant-seller was a payment instrument seller.\textsuperscript{32} A payment instrument includes a check, money order, travelers check, etc.\textsuperscript{33} Because bitcoin is property and not an actual currency, it did not meet the definition of “payment instrument;” the seller did not violate the statute by selling bitcoin.\textsuperscript{34} The court concluded “Bitcoin has a long way to go before it is the equivalent of money.”\textsuperscript{35} It dismissed the charge of unlawfully engaging in a money services business.\textsuperscript{36}

With respect to the money laundering charge, the court first considered the nature of money laundering. “‘Money laundering’ is commonly understood to be the method by which proceeds from illicit activity (‘dirty money’) becomes legitimized.”\textsuperscript{37} In Florida, it is illegal for an individual to be involved in a financial transaction involving property that is being used to facilitate an unlawful activity when the person’s conduct is intended to promote the unlawful activity. The transaction must involve a “monetary instrument.” A “monetary instrument” is an item such as U.S. currency, travelers’ checks, or personal checks. Bitcoin, a form of property, is not a monetary instrument.\textsuperscript{38} Moreover, because the bitcoin purchase was to be made with cash, and not the represented stolen credit card numbers, the court concluded the transaction did not facilitate an unlawful activity.\textsuperscript{39}

The court ended by observing that the seller-defendant was not promoting any illegal activity: he was merely selling his property. The buyer-detective’s claim that the seller intended to use the property for illicit purposes did not establish a crime. The court dismissed the money laundering charge.\textsuperscript{40}

\begin{itemize}
\item \textsuperscript{29}See \textit{FLA. STAT.} § 560.125(5)(a).
\item \textsuperscript{30}See \textit{FLA. STAT.} § 896.101(5)(a) and (b).
\item \textsuperscript{31}The government also failed to establish that defendant charged a fee for any money transmitting. \textit{Florida v. Espinoza}, Order Granting Defendant’s Motion to Dismiss the Information, at *4-5 (F14-2923, 2016).
\item \textsuperscript{32}See \textit{FLA. STAT.} § 560.103(30).
\item \textsuperscript{33}\textit{FLA. STAT.} § 560.103(29).
\item \textsuperscript{34}\textit{Florida v. Espinoza}, Order Granting Defendant's Motion to Dismiss the Information, at *5 (F14-2923, 2016).
\item \textsuperscript{35}\textit{Id.} at *6.
\item \textsuperscript{36}\textit{Id.}
\item \textsuperscript{37}\textit{Id.}
\item \textsuperscript{38}\textit{Id.} at *6-7.
\item \textsuperscript{39}\textit{Id.}
\item \textsuperscript{40}\textit{Id.} at *7.
\end{itemize}
IV. What About the Tax Implications?

The seller. In the case discussed, the seller explained to the detective what he was doing. He was selling appreciated property. Gain from the sale of appreciated property must be recognized by the seller. It is unclear from the court’s order granting the defendant’s motion to dismiss whether the seller reported any of the gain from the bitcoin sales, though it is beyond question that he should have. The reason he bought and sold bitcoins was to make a profit.

Valuation—the issue that usually complicates determining the amount of gain from the disposition of property—is not present in bitcoin purchases and sales. Valuation issues arise when there is no easily administrable means for determining what something is worth. For example, airlines years ago began awarding customers enrolled in frequent flyer programs “points” (i.e., virtual currency) when they purchase a ticket. When enough points are accumulated, customers can cash them in for a free ticket or use them to pay for food or hotel rooms or other items. The ability to earn points has since expanded. Now, many businesses have “rewards programs” that allow customers to earn reward points that can be used to purchase products or be converted to cash equivalents. Given the administrative burden of tracking and valuing the airline-awarded points, the Service announced it would not seek to tax points received as the result of business travel and used for personal purposes.

Because bitcoin tracks daily pricing information that is publicly available, the bitcoin value on the day of purchase and day of sale easily can be determined, without the use of experts or competing opinions on value or great uncertainty. Moreover, the Service has shown no hesitation in basing a tax deficiency on receipt of virtual currency. In Shankar v. Commissioner Mr. Shankar received “thank you points” as a noncash award for opening a bank account. He redeemed some of the points to purchase a plane ticket. The Tax Court held the points were given in exchange for the use of his money, making them interest. Because interest is taxable, Shanker had income equal to the value of the ticket.

For the seller-defendant, the only real difficulty would have been determining which bitcoin he sold. To the extent he held multiple bitcoins purchased on different days and at different prices, he would have needed to determine which bitcoins were sold to know the basis in each and, from there, the amount of gain or loss from each sale. Notice 2014-21 does not provide guidance on how a seller makes this determination.

Presumably, a seller could merely identify which bitcoins he sold. If he failed to do so, the fungibility of bitcoins suggests that an analogy could be made to stock sales. When a seller sells stock and does not adequately identify which stock was sold, the stock identification regulations treat the seller as having sold the last stock that was purchased (last in, first out). The same presumption could apply to a bitcoin seller.

When identical stock is purchased on the same day through a single trade order with an aggregate total cost reflected on the confirmation report, the stock identification regulations provide that the taxpayer can

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41 I.R.C. §1001(b). Of course, the seller also would be able to recognize any loss. I.R.C. §165(c)(1), (2).
42 Announcement 2002-18, 2002-1 C.B. 621. It excluded from amnesty situations where points were converted to cash. See Charley v. Commissioner, 91 F.3d 72 (9th Cir. 1996).
43 143 T.C. 140 (2014).
44 I.R.C. §61(a)(4).
47 Treas. Reg. §1.1012-1(c)(1)(i).
determine basis by averaging the cost of each share.\textsuperscript{48} Bitcoin, regardless of when purchased, has identical attributes, arguably making an average cost of all bitcoins purchased on a single day an option by analogy.\textsuperscript{49}

Not only would the seller-defendant be liable for the tax on the gains generated from the sales, but if he failed to report the gain, he would be liable for the negligence penalty.\textsuperscript{50} Negligence includes the failure to make a reasonable attempt to comply with the Code, exercise ordinary and reasonable care in preparing the return, keep adequate books and records, and substantiate items properly.\textsuperscript{51} In light of Notice 2014-\textsuperscript{21} classifying bitcoins as property, any failure by the seller to report gain from a disposition of bitcoins constitutes negligence.

Of course, if the seller-defendants’ failure to include the gain was intentional, he might be liable for the civil fraud penalty.\textsuperscript{52} The Service would have the burden of establishing that the seller committed fraud by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes.\textsuperscript{53} To satisfy this burden, the Service would have to show the seller engaged in wrongdoing with the specific intent to avoid a tax on the gain that he knew or believed to be due. Without direct evidence of the seller’s intent, the Service would look to circumstantial evidence through the so-called “badges of fraud.”\textsuperscript{54} More would have to be known before there could be any assumptions made about the applicability of the fraud penalty to the seller-defendant.

The peer-to-peer exchange. From the information provided in the opinion, it is difficult to determine if the peer-to-peer bitcoin exchange\textsuperscript{55} would be classified as a barter club or barter exchange subject to the rules applicable to such organizations. The website does not fit neatly into what might traditionally be thought of as a barter club. In the past, such organizations advertised themselves as that—barter clubs—for the purpose of attracting people who wanted to engage in barter transactions. The Service defines a barter exchange as

\begin{itemize}
  \item Understatement of income;
  \item Maintaining inadequate records;
  \item Giving implausible or inconsistent explanations of behavior;
  \item Concealing income or assets;
  \item Failing to cooperate with tax authorities;
  \item Engaging in illegal activities;
  \item Providing incomplete or misleading information to the taxpayer’s tax preparer;
  \item Lack of credibility of the taxpayer’s testimony;
  \item Filing false documents, including filing false income tax returns;
  \item Failing to file tax returns; and
  \item Dealing in cash.
\end{itemize}

\textsuperscript{48} Treas. Reg. §1.1012-1(c)(1)(ii).
\textsuperscript{49} It would seem this would come into play only when bitcoins are purchased from different sellers at different prices. One seller selling more than one bitcoin would charge the same price for all bitcoins purchased.
\textsuperscript{50} I.R.C. §6662.
\textsuperscript{51} I.R.C. §6662(c); Treas. Reg. §1.6662-3(b)(1).
\textsuperscript{52} The penalty is 75 percent of the underpayment that is attributable to fraud. I.R.C. §6663.
\textsuperscript{53} I.R.C. §7454.
\textsuperscript{54} No one factor is sufficient to establish fraud. A court may, however, consider a combination of several factors to be persuasive circumstantial evidence of fraud. Moreover, a court may infer an intent to mislead the Service from a pattern of conduct. The badges of fraud include:
\begin{itemize}
  \item Understatement of income;
  \item Maintaining inadequate records;
  \item Giving implausible or inconsistent explanations of behavior;
  \item Concealing income or assets;
  \item Failing to cooperate with tax authorities;
  \item Engaging in illegal activities;
  \item Providing incomplete or misleading information to the taxpayer’s tax preparer;
  \item Lack of credibility of the taxpayer’s testimony;
  \item Filing false documents, including filing false income tax returns;
  \item Failing to file tax returns; and
  \item Dealing in cash.
\end{itemize}
\textsuperscript{55} The exchange can be found at https://www.localbitcoins.com. This website allows buyers and sellers in specific locations, where it has a presence, to connect with each other.
Any person or organization with members or clients that contract with each other (or with the barter exchange) to jointly trade or barter property or services.56

Neither the Code nor the regulations include a definition of what it means to “barter property or services.” However, a barter transaction usually means a transaction where property or services are traded directly and no cash is involved.

To the extent bitcoins are purchased and sold for cash, the organization is a money transmitter business and not a barter club. If bitcoins are being exchanged for property or services, as with the Silk Road website where bitcoins were being exchanged for (illegal and illicit) goods and services, the exchange would be a barter club. In Espinoza, if most transactions resembled those suggested by the detective, bitcoin for stolen credit card numbers, the peer-to-peer exchange likely is a barter club. Without more information about the nature of the transactions, it is not possible to draw any conclusion about whether the website was a barter club.

From the seller-defendant’s perspective, it does not matter if the website is a barter club: commercial barter transactions are subject to tax the same as any other transactions.57 The classification as a barter club, however, might make a difference for the website. If the website is a barter exchange that has more than 100 transactions in a year, it is required to issue Forms 1099-B, Proceeds From Broker and Barter Exchange Transactions.58

Form 1099-B is an informational return59 provided to taxpayers so they can correctly complete their tax returns and verify that the amount reported to the Service is accurate and complete. A barter club may incur a penalty if it either fails to file an information return with the Service or fails to provide a copy of an information return to the payee. Irrespective of how many errors an information return contains, the Code imposes only one penalty of $250 per information return (with a maximum annual penalty60). The barter club can decrease the amount of the penalty to $50 per return if it corrects the error within 30 days of the due date of the return.61

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56 “The term does not include arrangements that provide solely for the informal exchange of similar services on a non-commercial basis.” Treas. Reg. §1.6045-1(a)(4). See also I.R.C. §6045(c)(3); Instructions for Form 1099-B (Barter Exchanges); IRS, Barter Exchanges (website information for small businesses).

57 I.R.C. §61(a)(1); Treas. Reg. §1.61-2(d); Rev. Rul. 79-24, 1979-1 C.B. 60. The Service has established a Bartering Tax Center that explains the tax consequences and the proper forms to be used to report a barter transaction. In addition, Publication 525, Taxable and Nontaxable Income, addresses the tax consequences of a barter transaction. See, e.g., Rooney v. Commissioner, 88 T.C. 523 (1987) (goods and services received as payment for services required to be included in income at retail value). See also Sergio Pareja, It Takes a Village: The Problem with Routinely Taxing Barter Transactions, 59 Cath. U. L. Rev. 785 (2010).

58 I.R.C. §6045; Treas. Reg. §1.6045-1. Taxpayers not participating in an exchange may be required to file a Form 1099-MISC. Note that the barter club itself may have tax consequences. See Barter Systems, Inc. of Wichita v. Commissioner, T.C. Memo. 1990-125 (barter exchange must report the fair market value of property received from members in exchange for trade units); Baker v. Commissioner, 88 T.C. 1282 (1987) (owner of barter exchange subject to tax).

59 Generally, information returns must be filed with the Service by March 1. I.R.C. §6721.

60 The maximum penalty is $3 million per calendar year or, for a small business with less than $5 million in gross receipts, $1,000,000. I.R.C. §6721(a), (d)(1)(A).

61 For the reduced penalty, the maximum amount is $500,000 per calendar year and $175,000 for a small business. If the barter club corrects the error 30 days after the due date (generally March 30) but before August 1, the penalty is $100 per return, and the maximum penalty is $1,500,000 per calendar year, $500,000 for small businesses. I.R.C. §6721(b), (d)(1) (B), (C).
Because the bitcoin seller was the focus of the detective's investigation and the Service was not clearly involved, it is unclear whether the Service would have taken the position that the peer-to-peer site should have been treated as a barter exchange required to issue Forms 1099-B. Moreover, it is not clear whether the site dealt with a sufficient number of barter transactions to make it a “barter club” subject to the reporting obligations.

V. Going Forward

In Espinoza, the detective and the members of the Task Force seemed to equate the buying and selling of bitcoin with engaging in an illegal activity. Certainly, their suspicions were not completely without foundation, as others who had bought and sold bitcoin had been convicted of the crimes with which they charged the seller-defendant.

The most well-known cases are likely those involving the Silk Road website. Thomas and Amanda Callahan served as a bitcoin exchanger (exchanging fiat currency into bitcoins and vice versa) for users of the Silk Road website. Clients sent Mr. Callahan cash, and he converted the cash into bitcoins.62 During a search of their house, Mrs. Callahan transferred 50.44 in bitcoins to the federal agents.63 In an action for forfeiture of the bitcoins, the court found the Callahans had failed to register their exchange service as a money service business with FinCEN, a criminal offense.64

Robert Faiella also was involved in the Silk Road website. He was charged with operating an unlicensed money transmitting business.65 Faiella received cash from his clients, converted the cash into bitcoins, and transferred the bitcoins to the client’s accounts on the Silk Road website.66 Bitcoins qualified as “funds” because they can easily be purchased in exchange for ordinary currency, act as a denominator of value, and be used to conduct financial transactions.67 Accordingly, having found all the elements under the statute, the court held Faiella could be held liable for running an unlicensed money transmitting business.68

The Financial Crimes Enforcement Network (FinCEN) is a bureau in the Treasury Department that operates as a bridge between law enforcement and the financial industry. One of its responsibilities is implementation of the Bank Secrecy Act (BSA),69 which includes a comprehensive federal anti-money laundering and counter-terrorism financing statute. The requirement to register a money transmitting business is part of the BSA.

A money transmitting business is a business that transmits funds between parties: it receives money from a customer and then transmits that money to a recipient in a place the customer designates. The customer pays a fee for the service.70 It includes a business that cashes checks or is a money transmitter service

63 At the time of the court’s decision, 50.44 bitcoin was worth approximately $27,000.
64 50.44 Bitcoins, 2016 WL at *2. Because the United States had established a connection between the bitcoins and a criminal offense, the bitcoins were forfeited. Id. at *2, n.5. See 18 U.S.C. §§ 981, 983.
66 Faiella, 39 F.Supp.3d at 546.
67 Id. at 545. See also United States v. Budovsky, 2015 WL 5602853, at *14 (S.D.N.Y. 2015).
68 Faiella, supra n. 83, at 547, denying the defendant’s motion to dismiss.
69 More specifically, FinCEN exercises regulatory functions primarily under the Currency and Financial Transactions Reporting Act of 1970, as amended by Title III of the USA PATRIOT Act of 2001 and other legislation, which legislative framework is commonly referred to as the Bank Secrecy Act.
Money transmitter services include accepting currency and transmitting the currency through an electronic funds transfer network. A money transmitting business or a money transmitter service must register with FinCEN and, in some states, with the state as a money service business. There is no requirement that the money transmitting business or the money transmitter service provider be engaged in an illegal activity, but it is illegal to knowingly run an unlicensed money transmitting business. FinCEN has ruled that a business that exchanges bitcoins is required to register with FinCEN as a money transmitting business.

The facts in Espinoza were different from the Silk Road cases. There was no evidence the seller was accepting cash to create a bitcoin account on behalf of the buyer, as Callahan and Faiella had done. In short, there was no evidence of anything other than that the seller was selling bitcoin for cash.

The fact the seller was selling bitcoin for cash should have raised the question of whether he was complying with the tax laws. Any potential tax implications from bitcoin as currency were put to rest when the Service ruled that bitcoins do not meet the definition of currency but are, instead, property. Accordingly, from a tax perspective, in Espinoza, the seller explained to the detective that he was selling appreciated property. Did he report the gain? This question seems to represent the lowest hanging fruit in terms of establishing the seller had done something wrong. However, nothing in the case suggests that avenue was pursued. Going forward, it might make more sense to first consider the more straight-forward tax implications of selling bitcoin. Moreover, by tracing how the bitcoin are being sold, the detective would have had the basic information needed to determine if the seller was in an unlicensed money transmitting business. If the information supported such an allegation, then the seller could have been so charged.

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71 31 C.F.R. §1010.100(ff).
72 31 U.S.C. §5330(d)(2). Other means of transfer are also included.
73 31 U.S.C. §330; 31 C.F.R. §1022.380(a)(1). A money services business includes any money transmitter, which is a person who transmits currency, funds, or value that substitutes for currency between people or locations. 31 C.F.R. §1010.100(ff)(5).
74 United States v. Dimitrov, 546 F.3d 409, 411 (7th Cir. 2008).
76 See Fin. Crimes Enforcement Network, Dep’t of Treasury Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies, FIN-2013-G001. It also clarified that a mere user of virtual currency is not engaged in a money transmitting business. Id.
77 Notice 2014-21, Sec. 2. See also U.S. Gov’t Accountability Off., GAO-14-496, Virtual Currencies: Emerging Regulatory, Law Enforcement, and Consumer Protection Challenges 4 (2014) (a virtual currency is “a digital representation of value that is not government-issued legal tender”); U.S. Gov’t Accountability Off., GAO-13-516, Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks 3 (2013) (a virtual currency is “a digital unit of exchange that is not backed by a government-issued legal tender. Virtual currencies can be used entirely within a virtual economy, or can be used in lieu of a government-issued currency to purchase goods and services in the real economy”); Fin. Crimes Enforcement Network, Dep’t of Treasury, FIN-2013-G001, Guidance: Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies 1 (Mar. 18, 2013) (virtual currency is “a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction.”).
VI. Conclusion

The traits that make bitcoin the virtual currency of choice for those engaged in illegal activities—peer-to-peer transfers, anonymity, encryption, and absence of an administrative clearing house—make bitcoins difficult to monitor for proper tax reporting and compliance purposes. Certainly, it will be favored by those involved in tax evasion schemes and illegal activities. The potential for misuse, however, goes well beyond that. With the tax consequences associated with using bitcoin mostly settled, the focus can shift to whether taxpayers are properly reporting their gains when disposing of bitcoins. This is especially true because, of all the avenues that might be pursued when considering a bitcoin seller engaged in shady behavior, not reporting gain from the bitcoin sales might have been the only case that was winnable. ■
Are insurance bad faith litigation recoveries taxable? The annoying answer is that it depends. This answer may be a bit less annoying with a brief description of what a bad faith claim may entail. It may be a tort or a contract claim, depending on the facts and the jurisdiction. It may be brought against one’s own insurance carrier, or sometimes, even against someone else’s carrier.

A common claim is that the insurance company defendant did not proceed appropriately to pay a claim, thus causing the plaintiff additional damages. In that sense, not unlike a legal malpractice claim against a lawyer, one key question will predate the bad faith case: what was the underlying issue (which may or may not have been litigated) that gave rise to the insurance claim? Most tax professionals will start to imagine a physical injury accident where the insurance company pays too little too late, and later must pay more for the same injuries via a bad faith claim. That is a useful (and common) example to bear in mind.

2009 IRS Ruling

The most important authority is a 2009 IRS private letter ruling (although technically letter rulings are non-precedential and not authority). It was a bombshell ruling when it was issued, and it suggests that some bad faith recoveries are tax free. Some case law, on the other hand, suggests that some taxpayers may be reading the ruling too broadly.

In Letter Ruling 200903073, a plaintiff had been employed as a construction worker, and in the course of his employment, was struck by a drunk driver. The drunk driver managed a tavern and had served himself liberally while on duty. The plaintiff was severely injured, and sued the driver/manager as well the tavern that had employed him.

The plaintiff received a jury verdict consisting of compensatory damages for his personal physical injuries, medical expenses, pain and suffering, lost earnings, plus punitive damages. After post-trial motions, the jury verdict was reduced to $X in compensatory damages and $Y in punitive damages. The defendants appealed.

Prior to the judgment, the insurer for the tavern (Insurance Company) had rejected an opportunity to settle for policy limits under the tavern’s policy. Under state law, the tavern as policy holder had a cause of action against Insurance Company if it acted in bad faith in failing to settle the claim. The tavern believed
In bad faith insurance cases, there is an underlying cause of action for which the taxpayer is seeking redress. It might be a personal physical injury action or something else. It may be viewed as a contract claim relating to the insurance policy, or as a tort claim related to the insurance company’s operations and its treatment of the plaintiff.

It had a bad faith cause of action against Insurance Company. Accordingly, the tavern entered into an agreement with the plaintiff to stay the execution of the plaintiff’s judgment and to assign to the plaintiff all claims possessed by the tavern and the tavern manager against Insurance Company related to bad faith. The assignment agreement also provided that within 30 days of the termination of the litigation against Insurance Company (whether by settlement or judgment), the judgment against the manager and the tavern (relating to plaintiff’s personal injury claims) would be marked “satisfied.”

Eventually, the plaintiff entered into a settlement agreement calling for the insurance company to pay $Z to plaintiff and his attorneys. The settlement agreement provided that upon receipt of payment, plaintiff would cause the bad faith insurance litigation to be dismissed with prejudice, and cause the personal injury judgment against the tavern manager and the tavern to be marked as satisfied.

Underlying Case Tax Free

The IRS starts its analysis in the Letter Ruling with the “origin of the claim” doctrine. Citing Raytheon Production Corp. v. Comm’r, the Service states that the critical inquiry here is in lieu of what were the damages awarded. The plaintiff may have recovered against Insurance Company, but the recovery had its origin in the settlement of the court cases against the tavern manager and the tavern. Indeed, the plaintiff was merely trying to collect on the plaintiff’s judgment against the manager and the tavern for damages awarded on his personal physical injury claim. “But for” the personal physical injury claim and the plaintiff’s rights as an assignee, the plaintiff would be receiving nothing from the insurer for the tavern. Quite literally, the plaintiff was only receiving money from Insurance Company because the plaintiff was injured.

Thus, the Service concluded that the section 104 exclusion applied. Interestingly, the Service noted that the exclusion would not apply to any amounts the plaintiff received that resulted from the punitive claims. Punitive damages are always taxable. Letter Ruling 200903073 expresses no opinion on allocating between compensatory and punitive damages.

Contract vs. Tort?

In bad faith insurance cases, there is an underlying cause of action for which the taxpayer is seeking redress. It might be a personal physical injury action or something else. It may be viewed as a contract claim relating to the insurance policy, or as a tort claim related to the insurance company’s operations and its treatment of the plaintiff.

The IRS has usually viewed them as contract actions. Regardless, it is relevant to inquire into the treatment of damages that, at least in part, often relate to the original act producing the underlying insurance claim. Not surprisingly, most bad faith insurance cases relate to the mishandling of insurance claims.

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2 144 F.2d 110 (1st Cir. 1944), cert. denied 323 U.S. 779 (1944).
3 See O’Gilvie v. U.S., 519 U.S. 79 (1995); see also IRC § 104.
Recent Cases

Perhaps as a result of the 2009 letter ruling, some taxpayers may think “tax free” when they hear “bad faith.” For example, in *Ktsanes v. Comm’t*[^4] (a summary opinion and therefore also non-precedential), the taxpayer worked for the Coast Community College District (“CCCD”) in Orange County, California. In connection with his employment, Ktsanes participated in a group long-term disability insurance program managed by Union Security.

The premiums were paid by Ktsanes’s employer, CCCD, and were not included in Ktsanes’s income. Ktsanes developed Bell’s palsy, which caused him to be unable to continue working for CCCD. He filed a claim for long-term disability with Union Security, which the insurance company denied, saying that Ktsanes was not sufficiently disabled to qualify.

Ktsanes filed a bad faith claim against Union Security. The claim was settled for $65,000. Ktsanes claimed the settlement payment was received on account of a physical sickness (the Bell’s palsy), and therefore excluded it from his gross income under section 104(a)(2). When the IRS disagreed, Ktsanes also argued that the group long-term disability insurance program was equivalent to a workmen’s compensation payment, so was excludable under section 104(a)(1).

The Tax Court rejected both arguments and found the settlement to be taxable. The court reasoned:

> The relief that petitioner sought in his complaint was causally connected (and strongly so) to the denial by Union Security of his claim for long-term disability benefits. Although petitioner’s complaint alleged that he became disabled as a result of physical injuries or sickness, this “but for” connection is insufficient to satisfy the “on account of” relationship discussed in *O’Gilvie*[^5] for the purposes of the exclusion under section 104(a)(2). Petitioner would not have filed his complaint if Union Security had not denied his claim but instead paid him the long-term disability payments that he sought. In other words, petitioner sought compensation “on account of” the denial of his long-term disability benefits, not for any physical injuries or physical sickness.^[6]

On the surface, this reasoning might make it difficult for bad faith recoveries to qualify under section 104(a)(2). Indeed, when taxpayers claim that bad faith recoveries are excludable from gross income under section 104(a)(2), the personal physical injury or physical sickness almost always concerns the facts that gave rise to the insurance claim, rather than the denial of the claim itself. Put differently, relatively few bad faith claimants can assert that the insurance company actually caused them physical harm.

Nevertheless, some plaintiffs can claim that insurance company delays exacerbated their physical injuries and physical sickness. In that kind of case, the argument for excluding all or part of the eventual bad faith recovery can be strong. In *Ktsanes*, though, the Tax Court concludes the opinion in a way that cuts off that possibility.

The $65,000 that [Ktsanes] received in settlement of his suit essentially represented a substitute for what he would have received had his claim been approved. Under these circumstances, no part of that payment is excludable under any subdivision of IRC § 104(a).7

This language, emphasized by its placement at the very end of the opinion, seems to contradict the court’s previous language. It looks through the insurance claim to the facts that gave rise to the insurance claim. Moreover, it implicitly asks how the payment would have been taxed had the insurance claim been paid without dispute. The taxation of an undisputed payment would surely depend on the facts that gave rise to the insurance claim.

In Ktsanes, the court seems bothered by section 104(a)(3). Notably, Ktsanes did not raise this sub-section as a basis for excluding the settlement payment from his income. Under section 104(a)(3), amounts received through accident or health insurance for personal injuries or sickness are excludable from gross income. The key qualifier, of course, is that the premiums for the insurance must not have been paid by the insured’s employer as a tax-free benefit to the insured. Ktsanes’s long-term disability premiums were paid by his employer and were not included in his income. Thus, he clearly did not qualify for tax-free treatment under section 104(a)(3). Had his insurance claim been paid without dispute, it would presumably have been taxable.

Read in this light, Ktsanes is much more easily reconciled with the other authorities on bad faith litigation. The Tax Court may have been preventing insurance payments that were income from being made tax-exempt merely because the insurance company only agreed to pay the insurance claim after litigation.

Another case decided shortly after the 2009 letter ruling is more troubling. In Watts v. Comm’r,8 the taxpayer sued her automobile insurer claiming breach of contract after she sustained physical injuries in a collision with an uninsured motorist. The parties settled for an amount in excess of Watts’s $50,000 policy limit. Watts excluded the settlement under section 104(a)(2), but the IRS disallowed the exclusion, asserting that the breach-of-contract action was not based on tort or tort-type rights. (Of course, that requirement originating in the Schleier case9 is now obsolete.) Showing a bit of prescience, the taxpayer and the government nonetheless agreed that the settlement should be analyzed under section 104(a)(2).

The Tax Court took a dim view.

The parties apparently believe that the interposing of a lawsuit between the insured and the insurer in this case causes the payment petitioner received from State Farm to constitute “damages” that may be excluded from income only by satisfying the requirements of [IRC. § 104(a)(2)]. We disagree.10

Instead, the Tax Court analyzed the settlement payment under section 104(a)(3) concerning amounts received “through” accident or health insurance “for” personal injuries or sickness. The Tax Court concluded that the settlement payment could be excluded under that section up to the policy limits but was taxable interest or other taxable income to the extent the settlement payment exceeded Watts’s $50,000 policy limit.

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8 T.C. Memo. 2009-103.
10 T.C. Memo. 2009-103 at *5.
In Watts, as in Ktsanes, the Tax Court seemed focused on making sure that section 104(a)(2) does not override section 104(a)(3) in bad faith and breach of contract cases regarding insurers. Where the proceeds of bad faith or breach of contract cases would cause payments from insurers to be taxed differently from how the same payments would be taxed if paid by the insurer without dispute, taxpayers might expect the Tax Court to either refuse to apply section 104(a)(2) altogether (as in Watts), or to construe its “on account of” language narrowly to render the subsection inapplicable (as in Ktsanes).

Notably, though, Letter Ruling 200403046\(^\text{11}\) ruled that legal fees allocable to disability benefits were excludable under section 104(a)(3). The ruling involved a taxpayer who purchased disability insurance with after-tax dollars. The taxpayer was disabled on the job, but his claim was denied. The taxpayer thereafter filed suit against the insurance company, alleging bad faith and contract damages. The taxpayer prevailed, but the insurance company appealed. The matter settled on appeal, and the taxpayer recovered attorney fees and costs. The IRS ruled that because the underlying recovery was excludable under section 104(a)(3), the recovered attorney fees and costs were also excludable.

Hauff v. Petterson\(^\text{12}\) is not a tax case. But it is worth reading even if one is focused solely on the taxes. Instead of analyzing a bad faith recovery to ascertain how it should be taxed, the court uses the taxability of a recovery to determine whether the insurance company acted in bad faith.

David Hauff filed a claim with his automobile insurer after he was involved in a collision with an uninsured motorist and sustained physical injuries. Among other things, he requested compensation for lost wages. Hauff’s insurance carrier agreed to pay him an amount of lost wages based on Hauff’s wages net of the income tax that he would normally have to pay on them. Hauff demanded that his lost wages be calculated based on his gross lost wages, and filed suit against his insurer alleging bad faith.

The court determined that amounts received by Hauff for lost wages would be excludable from his income under section 104(a)(2) as amounts received on account of a personal physical injury or physical sickness. Because Hauff would not have to pay tax on the amounts received from his insurer, the court found that the insurer was acting in good faith by only paying Hauff his net lost wages. As a result, the court found for the insurer on summary judgment.

Another case (a summary opinion and also non-precedential) that predates the 2009 letter ruling is interesting nonetheless. In Braden v. Comm’r,\(^\text{13}\) Braden received $30,000 from a class action settlement with his automobile insurance company. The action was a breach of contract bad faith claim related to underlying physical injury claims Braden had made against the insurance company. Braden excluded the $30,000 from his gross income under section 104. The IRS disagreed, and the matter went to Tax Court.

The IRS moved for summary judgment, arguing that the underlying cause of action was not based on a tort or tort-like rights and therefore could not be excludable under section 104. The Tax Court denied the
motion, stating that the nature of the taxpayer’s claim controlled. The fact that this lawsuit was for breach of contract did not foreclose the possibility that the taxpayer’s claim was for personal physical injuries.

**Conclusion**

Considering how many claims insurance companies face for putatively bad faith behavior, it is surprising that there are not more tax cases considering the treatment to the plaintiff. Some bad faith plaintiff’s lawyers report that they routinely see clients pay tax on the recoveries without complaint. Some plaintiffs may exclude them from income without much thought, and perhaps there are few disputes.

Despite the relative paucity of cases, it seems reasonable to believe that there are an increasing number of bad faith settlements and judgments. Not all involve good arguments for exclusion, but some do. And sometimes the way to get to that position can require some creativity.

Indeed, Letter Ruling 200903073 involved a bad faith claim that was originally owned by the tavern policy holder. The claim was later pursued by an injured plaintiff who recovered “on account of” his injuries. The assigned bad faith claim enabled the plaintiff to sue the carrier. However, it was the nature of the underlying injury and the plaintiff’s claim against the tavern and tavern manager that sparked the assignment. And it was the underlying injury that ultimately led to the recovery. ■
PRACTICE POINT

Recent Developments Affecting Qualified and Nonqualified Deferred Compensation, Part II: The New Department of Labor Fiduciary Rule

By David Pratt, Professor of Law, Albany Law School, Albany, NY

Introduction

As of June 30, 2016, total U.S. retirement plan assets were $24.5 trillion, more than twice the $11.6 trillion reported for 2000.\(^1\) That is a very large amount of money—significantly larger than the GDP of the United States or China, the world’s two largest economies; more than 30 times the market value of the world’s most valuable company, Alphabet, the parent of Google; and more than 300 times the net worth of the world’s richest individual, Bill Gates.

The largest single component of retirement plan assets is the $7.5 trillion held in individual retirement accounts (IRAs), considerably more than the $4.9 trillion held in 401(k) plans. Between IRAs, 401(k) plans, and plans sponsored by small employers, an enormous pool of retirement funds is invested by what the U.S. Department of Labor (DOL) calls “retail investors.” The growth of IRAs is almost entirely attributable to tax-free rollovers from 401(k)s and other employer plans, and the vast majority of 401(k) plans allow participants to direct how their accounts are invested. Accordingly, the Obama administration, the Government Accountability Office and pension experts (among others) have expressed concern in recent years regarding the integrity of the IRA rollover process and the quality of the investment advice retail investors receive in connection with retirement asset rollover and investment decisions.

In addition to these tax-favored retirement savings, many employers make additional “nonqualified” deferred compensation available to their high-level employees. A 2015 report by the Center for Effective Government and the Institute of Policy Studies found that the 100 largest U.S. CEO retirement packages were worth $4.9 billion, equal to the entire retirement savings of 41% of American families.\(^2\)

ERISA and Fiduciaries

The Employee Retirement Income Security Act (ERISA) was enacted on September 2, 1974.\(^3\) Title I (the “labor” title) describes the rights of employee benefit plan participants and beneficiaries and the obligations of fiduciaries. The DOL has enforcement authority under Title I. A person is a fiduciary with respect to a plan

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\(^1\) Investment Company Institute, Retirement Assets Total $24.5 Trillion in Second Quarter 2016.

\(^2\) A Tale of Two Retirements.

\(^3\) Pub. L. 93-406, codified, as amended, in scattered sections of Titles 26 and 29 of the U.S. Code.
to the extent that, inter alia, the person “renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so.”4 Most employer-sponsored plans are subject to Title I; IRAs, unless employer-sponsored, are not.

Both ERISA and the Internal Revenue Code (Code) prohibit fiduciaries and certain other parties from engaging in prohibited transactions with respect to a retirement plan. The ERISA prohibited transaction rules do not apply to IRAs, but the Code rules do.5 The Code includes an essentially identical definition of “fiduciary” for that purpose.6 The Code does not impose the same standards of conduct on fiduciaries that ERISA does,7 and, unlike ERISA, it does not establish a private right of action for participants, beneficiaries and IRA owners against fiduciaries. Instead, the Code’s prohibited transaction rules are enforced through excise taxes imposed by the Treasury Department.8

Originally, the IRS and DOL both had jurisdiction over prohibited transactions. Reorganization Plan No.4 of 1978 transferred to the Secretary of Labor authority to issue certain regulations under section 4975, including regulations relating to the section’s definition of “fiduciary”.9

The DOL Fiduciary Rule

Approximately one year after ERISA was enacted, the DOL issued a regulation defining “investment advice”. The IRS issued an essentially identical regulation under section 4975. In October 2010, the DOL published a proposed rule to amend the 1975 regulation.10 The proposed rule was highly controversial, and the DOL announced in September 2011 that it was withdrawing the proposed regulation and would re-propose it. On April 20, 2015, the DOL published its revised proposed fiduciary rule and several proposed new or amended prohibited transaction exemptions (PTEs) for financial professionals and others falling within the new fiduciary definition.11

The DOL received more than 3,000 comments on its proposal, many of them expressing concerns with the proposed changes.

The DOL’s explanation for the new rule appears in the preface to the final rule published in April 2016.

The Department created the five-part test in a very different context and investment advice marketplace. The 1975 regulation was adopted prior to the existence of participant-directed 401(k) plans, the widespread use of IRAs, and the now commonplace rollover of plan assets from ERISA-protected plans to IRAs. Today, as a result of the five-part test, many investment professionals, consultants, and advisers have no obligation to adhere to ERISA’s fiduciary standards or to the prohibited transaction rules, despite the critical role they play in guiding plan and IRA investments. Under ERISA and the Code, if these advisers are not fiduciaries, they may operate with conflicts of interest that they need not disclose and have limited liability under federal pension law for any harms resulting from the advice they provide. Non-

4 ERISA § 3(21)(A).
5 I.R.C. § 4975(e)(1).
6 I.R.C. § 4975(e)(3).
7 See ERISA §§ 404 et seq.
8 I.R.C. § 4975(a), (b).
fiduciaries may give imprudent and disloyal advice; steer plans and IRA owners to investments based on their own, rather than their customers’ financial interests; and act on conflicts of interest in ways that would be prohibited if the same persons were fiduciaries. In light of the breadth and intent of ERISA and the Code’s statutory definition, the growth of participant-directed investment arrangements and IRAs, and the need for plans and IRA owners to seek out and rely on sophisticated financial advisers to make critical investment decisions in an increasingly complex financial marketplace, the Department believes it is appropriate to revisit its 1975 regulatory definition as well as the Code’s virtually identical regulation. With this regulatory action, the Department will replace the 1975 regulations with a definition of fiduciary investment advice that better reflects the broad scope of the statutory text and its purposes and better protects plans, participants, beneficiaries, and IRA owners from conflicts of interest, imprudence, and disloyalty.12

The New DOL Fiduciary Regulation

The new rule significantly expands the definition of who is a fiduciary by virtue of giving investment advice. For purposes of ERISA section 3(21)(A)(ii) and Code section 4975(e)(3)(B), a person will generally be deemed to be “rendering investment advice with respect to moneys or other property of a plan or IRA”, and thus a fiduciary, if the following provisions apply:

(1) The person provides, for a fee or other compensation, direct or indirect:

   (i) A recommendation as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property, or

   (ii) A recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from a retirement plan or IRA; or

   (iii) A recommendation as to the management of securities or other investment property, including recommendations with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made; and

(2) With respect to the investment advice described in (1), the recommendation is made either directly or indirectly (e.g., through or together with any affiliate) by a person who:

   (i) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act or the Code; or

   (ii) Renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient; or

(iii) Directs the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.\(^\text{13}\)

The advice may be provided to a retirement plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner.

A “recommendation” means a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.\(^\text{14}\) The determination of whether a “recommendation” has been made is an objective rather than subjective inquiry. The more individually tailored the communication is, the more likely that the communication will be viewed as a recommendation. The regulation identifies various activities that are not recommendations\(^\text{15}\) and provides exceptions for certain transactions.\(^\text{16}\)

A new prohibited transaction exemption, the Best Interest Contract Exemption (BICE),\(^\text{17}\) is designed to promote the provision of investment advice that is in the best interest of retail investors: plan participants and beneficiaries, IRA owners, and certain plan fiduciaries, including small plan sponsors.

As a condition of receiving compensation that would otherwise be prohibited under ERISA and the Code, the exemption requires Financial Institutions to acknowledge their fiduciary status and the fiduciary status of their Advisers in writing. The Financial Institution and Advisers must adhere to enforceable standards of conduct and fair dealing with respect to their advice. In the case of IRAs and non-ERISA plans, the exemption requires that the standards be set forth in an enforceable contract with the Retirement Investor. Under the exemption's terms, Financial Institutions are not required to enter into a contract with ERISA plan investors, but they are obligated to adhere to these same standards of fiduciary conduct, which the investors can effectively enforce pursuant to ERISA sections 502(a)(2) and (3). Likewise, “Level Fee” Fiduciaries that, with their Affiliates, receive only a Level Fee in connection with advisory or investment management services, do not have to enter into a contract with Retirement Investors, but they must provide a written statement of fiduciary status, adhere to standards of fiduciary conduct, and prepare a written documentation of the reasons for the recommendation. . . . The exemption strives to ensure that Advisers' recommendations reflect the best interest of their Retirement Investor customers, rather than the conflicting financial interests of the Advisers and their Financial Institutions.\(^\text{18}\)

Under this standards-based approach, the Adviser and Financial Institution must give prudent advice that is in the customer’s best interest, avoid misleading statements, and receive no more than reasonable compensation. Additionally, Financial Institutions generally must adopt policies and procedures reasonably designed to mitigate any harmful impact of conflicts of interest, and disclose basic information about their conflicts of interest and the cost of their advice. Level Fee Fiduciaries are subject to more streamlined conditions, including a written statement of fiduciary status, compliance with the standards of impartial

\(^{13}\) 29 C.F.R. § 2510.3-21(a) (emphasis added).

\(^{14}\) 29 C.F.R. § 2510.3-21(b)(1) (emphasis added).

\(^{15}\) 29 C.F.R. § 2510.3-21(b)(2).

\(^{16}\) 29 C.F.R. § 2510.3-21(c).


\(^{18}\) 81 Fed. Reg. at 21003.
conduct, and, as applicable, documentation of the specific reason or reasons for the recommendation of the Level Fee arrangement.¹⁹

The Department also granted a new Principal Transactions Exemption, published in the same issue of the Federal Register, that permits investment advice fiduciaries to sell or purchase certain debt securities and other investments in transactions with plans and IRAs.²⁰ The DOL also amended other existing exemptions to ensure uniform application of the Impartial Conduct Standards.²¹

Prior to the issuance of the new rule, the sale of insurance and annuity products fell with the relatively liberal rules of PTE 84-24. Advisers and Financial Institutions are permitted to receive compensation in connection with the sale of insurance and annuity contracts. In the same issue of the Federal Register, however, the Department limited the relief available under PTE 84-24 to “fixed rate annuity contracts”. Fixed rate annuity contracts do not include variable annuities or indexed annuities or similar annuities. As a result of this change, the new rule is particularly unpopular with providers in the insurance industry, notably those who sell indexed annuities to retirement plans and IRAs. On the other hand, critics of the ability of advisers to put their own interest above the interest of the consumers they advise have lauded the rule as providing particularly important consumer protections.²²

**Lawsuits Challenging the Fiduciary Rule**

During the first two weeks of June 2016, five separate federal lawsuits were filed challenging the final rule on various grounds.²³ A sixth case was filed in September, 2016.²⁴ Three cases were filed in the Northern District of Texas,²⁵ one in the District of Columbia,²⁶ one in Kansas, and the sixth in Minnesota.²⁷ The three Texas cases have been consolidated, and a June 24, 2016 joint motion states that the parties have agreed to proceed “on cross-motions for summary judgment without discovery or any other evidentiary proceedings.”²⁸ A summary judgment hearing in the D.C. case took place on August 25, 2016.²⁹ The Kansas court heard arguments on September 21, 2016.³⁰ The Texas court has scheduled a summary judgment hearing for November 17, 2016.³¹

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¹⁹ Id.
²¹ “Taken together, the new exemptions and amendments to existing exemptions ensure that Retirement Investors are consistently protected by Impartial Conduct Standards, regardless of the particular exemption upon which the adviser relies.” 81 Fed. Reg. at 21007.
²² See, e.g., Consumer Federation of America, 6 Ways the DOL Fiduciary Rule Improves Protections for Retirement Savers (Apr. 6, 2016).
²³ See David Pratt, Focus On... Lawsuits Challenging The Department of Labor’s Fiduciary Rule, JOURNAL OF PENSION BENEFITS (forthcoming 2016). The Texas lawsuit, for example, claims that the rule “oversteps the DOL’s authority [and] creates unwarranted burdens and liabilities” (among other issues raised in the complaint). See Greg Iacurci, Nine groups file lawsuit to strike down ‘capricious’ DOL fiduciary rule, Investment News (Jun 2, 2016).
²⁵ The lead plaintiffs are the U.S. Chamber of Commerce, the American Council of Life Insurers and the Indexed Annuity Leadership Council.
²⁶ The plaintiff is the National Association for Fixed Annuities.
²⁷ The plaintiff is Market Synergy Group, Inc., an insurance agency based in Topeka.
²⁸ Mark Schoeff Jr., Litigation schedule set for suits against DOL fiduciary rule, INVESTMENT NEWS (Jun 27, 2016).
³¹ Mark Schoeff Jr., Dallas court schedules hearing for lawsuits against DOL fiduciary rule, INVESTMENT NEWS (July 8, 2016).
Most observers believe that the lawsuits are unlikely to succeed on their merits. They may, however, delay the proposed implementation of the rule, different parts of which are scheduled to take effect in 2017 and 2018. In addition, there is significant opposition to the rule in Congress. On June 8, 2016, President Obama vetoed a resolution, approved by the House in April and the Senate in May, to kill the DOL fiduciary rule.32 If the Republicans win the Presidency and retain control of the House and Senate in the November elections, the rule will almost certainly be killed, one way or another. Even if Secretary Clinton wins the Presidency, her administration might not support the rule as strongly as President Obama and Secretary Perez have done.

Conclusion

It is too early to predict the effect of the new fiduciary rule, if it survives. Supporters contend that it will improve the quality of advice received by retirement investors, thus increasing retirement security. Detractors claim that it will make advice unaffordable or unattainable for many, and that its benefits are outweighed by its costs.

32 Mark Schoeff Jr., Obama vetoes resolution against DOL fiduciary rule, INVESTMENT NEWS (June 8, 2016).
OPINION POINT

Time to Change the Casualty Loss Deduction

By Patrick E. Tolan, Jr., Associate Professor, WMU-Cooley Law School, Tampa Bay, FL

Eight of the ten most costly disasters in U.S. history have happened in the last 15 years. Some of these—especially 9/11 and Hurricane Katrina—triggered unprecedented tax relief for casualty losses.1 Others, such as Hurricane Sandy, led to no additional tax relief whatsoever.2 That is, Congress's 21st century post-disaster responses have ranged from multi-billion dollar tax relief targeted at discrete, identified, disaster zones3 to no additional substantive tax relief at all. At the same time, victims of more common casualties, like house fires, lightning strikes, isolated floods, and tornadoes, receive only the limited section 165 casualty loss deduction. Although not as newsworthy, these common tragedies may result in losses to an individual casualty victim at the same or even higher levels than losses suffered by victims of more widespread disasters. Congressional action thus seems to be more dependent on human emotion and political whim than sound tax policy. The increased likelihood of all casualties, coupled with the escalating costs of major disasters (see Table 1), makes reconsideration of the tax treatment of casualty losses a timely and important issue.

1 I.R.C. §§ 139 and 1400L were added after 9/11 giving casualty loss relief to individuals who needed humanitarian aid and those who had lost property or loved ones, and creating tax incentives for individuals and businesses in the “Liberty Zone” disaster area. Within a month of Hurricane Katrina, the Katrina Emergency Tax Relief Act (KETRA) afforded $5.2 billion in tax relief to hurricane victims. Joint Committee on Taxation, Estimated Revenue Effects of H.R. 3768, Doc. No. JCX-65-05R (Sept. 15, 2005) (casualty loss deduction was the costliest item at over $2.4 billion). KETRA was followed three months later by the Gulf Opportunity Zone Act (GOZA), expanding the nature and scope of relief to GO Zones affected by Hurricanes Katrina, Rita, and Wilma. Pub. L. 109–135, title I, §§ 101(a), 102(a), 201(a), Dec. 21, 2005, 119 Stat. 2578-2607 (adding I.R.C. §§ 1400M, 1400N, 1400O, 1400P, 1400Q, 1400R, 1400S, and 1400T).

2 Legislation that stalled in committee in 2015 would have retroactively extended tax relief from 2012 (the year of Hurricane Sandy) to Dec. 31, 2015. National Disaster Tax Relief Act of 2015, S. 1795, 114th Cong. (as referred to S. Comm. on Finance, July 16, 2015).

3 See e.g. JCX-65-05R, supra note 1.

Because the credit is refundable, it would be available to those who take the standard deduction as well as to those who itemize, and it would be provided to the working poor even if they have no tax liability. Finally, it could be phased out for taxpayers in the highest marginal tax bracket, since these taxpayers can best afford to self-insure or to pay to be fully insured.
Table 1: Losses from Major Disasters from 1994-2012

<table>
<thead>
<tr>
<th>Most Costly Disasters in US History</th>
<th>Insured Losses in Constant 2015 Dollars</th>
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</thead>
<tbody>
<tr>
<td>1. Hurricane Katrina (Aug. 2005)</td>
<td>$ 49,047,000,000</td>
</tr>
<tr>
<td>2. Terrorist Attacks of Sept. 11th, 2001</td>
<td>$ 24,613,000,000</td>
</tr>
<tr>
<td>3. Hurricane Andrew (Aug. 1992)</td>
<td>$ 24,111,000,000</td>
</tr>
<tr>
<td>4. Hurricane Sandy (Oct. 2012)</td>
<td>$ 19,563,000,000</td>
</tr>
<tr>
<td>5. Northridge, CA Earthquake (Jan. 1994)</td>
<td>$ 18,597,000,000</td>
</tr>
<tr>
<td>6. Hurricane Ike (Sept. 2008)</td>
<td>$ 13,826,000,000</td>
</tr>
<tr>
<td>7. Hurricane Wilma (Oct. 2005)</td>
<td>$ 12,292,000,000</td>
</tr>
<tr>
<td>8. Hurricane Charley (Aug. 2004)</td>
<td>$ 9,207,000,000</td>
</tr>
<tr>
<td>9. Hurricane Ivan (Sept. 2004)</td>
<td>$ 8,758,000,000</td>
</tr>
<tr>
<td>10. Flooding, hail, wind, and tornadoes including the tornadoes that struck Tuscaloosa and other locations (Apr. 2011)</td>
<td>$ 7,757,000,000</td>
</tr>
</tbody>
</table>

This article proposes to reform section 165 to create a refundable credit for casualty losses to solve the three most significant problems with current tax policy in this area: 1) disparate treatment of victims of different disasters; 2) higher tax relief for wealthy taxpayers than for the poor; and 3) substantial government relief to those who engage in the riskiest (and potentially costliest) behavior. The refundable credit would be linked to proof of insurance and would be reduced or eliminated for those with uninsured losses. Because the credit is refundable, it would be available to those who take the standard deduction as well as to those who itemize, and it would be provided to the working poor even if they have no tax liability. Finally, it could be phased out for taxpayers in the highest marginal tax bracket, since these taxpayers can best afford to self-insure or to pay to be fully insured.

This article will first summarize the evolution of the casualty loss deduction as a basis for understanding the problems with its 21st century application. The remaining parts will focus on the proposed remedy of a refundable credit.

I. Section 165 Casualty Loss Relief Is Inequitable

The first casualty loss deduction dates back to 1864. The Casualty Loss Deduction and Consumer Expectation: Section 165(c)(3) of the Internal Revenue Code, 36 Univ. of Chicago L. Rev. 220 (1968) (Editors).
During WWII, the standard deduction was introduced as an easier alternative for taxpayers who preferred not to maintain detailed records to justify itemization while still providing a reasonable amount to offset typical taxpayer deductible expenses. The casualty loss deduction has since been codified as an itemized deduction for individuals and businesses under section 165 (except for tax years 2008 and 2009, as described below). Unlike businesses, which may deduct the full out-of-pocket loss for any disaster, individuals are subject to a casualty loss threshold (equal to $100 plus 10% of adjusted gross income (AGI)) before relief is allowed. If a single taxpayer has no other itemized deductions, then there is no financial advantage to itemizing in order to claim the casualty loss until the casualty loss exceeds 10% of the taxpayer’s AGI by $6,400 (the 2016 standard deduction plus $100). Taxpayers who are married filing jointly would need to sustain a loss of more than $12,700 plus 10% of their AGI if they had no other itemized deductions. While each taxpayer’s circumstances are unique, it is nevertheless clear that those who already itemize are better positioned under the existing scheme than those with few itemized deductions.

After Hurricanes Katrina, Wilma, and Rita in 2005, Congress waived the $100 deduction limitation and the 10% AGI threshold for individuals in affected areas. After Hurricane Ike and the “Heartland Disasters” of 2008, Congress extended similar relief to all individuals in any federally declared disaster area for all of 2008 and 2009. This “National Disaster Relief Act of 2008” was the first time Congress prospectively authorized enhanced casualty loss relief for major disasters. Because the relief was only afforded to those in declared disaster areas, however, horizontal equity was violated. Taxpayers with identical income and casualty losses faced disparate treatment based solely on whether the casualty itself occurred in a federally declared disaster area. To illustrate, all other things being equal, a single taxpayer in the 28% bracket with $100,000 AGI in a federally declared disaster area would have a tax advantage of $2,900 compared to a similarly situated taxpayer outside of a declared disaster area (each victim suffering similar net casualty losses of over $10,000). Although this inequitable treatment expired after December 31, 2009, legislation has repeatedly been proposed over the past few years to extend the waiver of the 10% AGI casualty loss limitation in declared disaster areas.

Any such extension of the waiver of the 10% AGI casualty loss limitation would also undermine vertical equity, because the section 165 reduction of deductible losses by 10% AGI at least serves as a surrogate for progressivity. Without it, any deduction has an “upside down” quality by allowing more tax relief for taxpayers in higher brackets than those in lower brackets. Without the limitations in section 165(h)(2), for example, a taxpayer in the 15% bracket suffering a $10,000 net casualty loss would obtain up to $1,400 of tax relief; in contrast a taxpayer in the 28% bracket facing the same $10,000 net casualty loss would garner up to $2,900 of relief or nearly twice as much (again applying the taxpayer’s marginal tax rate to determine the deduction available).

This vertical equity flaw was demonstrated in exaggerated form in the IRS Statistics of Income reported for 2008-2009 (the only two years when the 10% AGI limitation did not apply). The average deduction for

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7 Compare I.R.C. § 165(c)(1-2) with I.R.C. § 165(c)(3).
9 Basically, a federally declared disaster occurs whenever the President declares an area a National Disaster Area under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. I.R.C. § 165(i)(5).
10 I.R.C. § 706(a).
11 This amount is determined by applying the 28% marginal tax rate to the entire casualty loss deduction. 10% x $100,000 x 28% = $2,800 + $100 = $2,900.
12 See e.g. National Disaster Tax Relief Act of 2015 (S. 1795), Sec. 103; National Disaster Tax Relief Act of 2014 (S. 2634), Sec. 103.
those with AGI in excess of $10 million was $441,490. This grossly exceeds the average casualty loss deduction of $2,000-$16,000 for individuals with less than $200,000 AGI. Of course, those with no tax liability after their other deductions and exemptions enjoy no casualty loss tax relief; yet arguably these working poor are the taxpayers who can least afford to fully insure or to bear the burden of their losses without government support.

The final problem with the existing scheme is that those who are most underinsured or uninsured receive the most tax relief. In economic terms, this is known as moral hazard, because these taxpayers are not bearing the full brunt of their risky behavior.

II. Replacing the Deduction with a Uniform Refundable Credit

The value of tax relief afforded by a casualty loss deduction depends on the applicable tax rates of the taxpayers suffering a casualty loss. As a result, those in lower brackets receive comparatively less relief than those in higher brackets (where relief is equal to the tax rate times the allowed deduction). A tax credit, unlike a deduction, reduces taxes dollar-for-dollar. A credit can be capped at the amount of tax relief that the government determines merits a subsidy. Furthermore, a credit can be refundable, meaning that the full value of the credit is payable in cash to eligible taxpayers who have no tax liability.

A. Rationales for a Refundable Credit

There are a number of reasons that a uniform refundable credit would provide a better approach to casualty loss taxation than the current deduction.

First, a refundable credit should reduce the psychological pressure on Congress to allow special tax relief as an attempt to help victims every time an especially salient disaster occurs that garners national attention. As the tales of storms Katrina and Sandy suggest, congressional response to a major disaster fluctuates from no tax relief to multi-billion dollar relief depending on the impact and visibility, political circumstances, and even inurement to tragedy that surrounds a particular disaster. Such a result is almost certain to be inconsistent and unfair as to those who have been involved in major disasters. Moreover, it will always be unfair towards those who suffer similar losses that are not part of federally declared disasters.

Second, the government should provide a real measure of relief for citizens who suffer major casualty losses. Eliminating the casualty loss provision would be problematic, because it would remove the safety net for those it now assists. Providing a refundable credit delivers more assistance to those that need it. If the government is going to allow any tax expenditures to foster social objectives at all, then it should consider the relative merits of the competing measures when deciding which measures to extend and which to curtail. While people may always disagree about the level of social support or security the government ought to offer, most would likely support assistance for victims of tragedy. It appears that there is as strong an argument for them—especially for those in the lower income brackets—as there is for tax relief for

13 IRS, SOI Table 2.1, 2008, 2009. This number combines the total casualty losses taken by those with AGI over $10 million in 2008 ($32.415 million) and 2009 ($13.5 million) by the 104 total taxpayers (90 taxpayers over $10 million annual income in 2008 and 14 in 2009). $45,915,000/104=$441,490.
14 See id. Calculations are more elaborate for those earning less than $200,000 AGI, because each level of AGI listed in Table 2.1 had to be calculated individually. For example, there were 89,357 and 30,589 taxpayers in the $100,000 to $200,000 bracket in 2008 and 2009, respectively. These taxpayers claimed deductions of $921.150 and $754.472 million, respectively. The total claimed over both years was $1.675622 billion. This number was then divided by the total number of taxpayers claiming in both years (119,946), yielding an average of $13,969.80. The same process was applied to all the AGI categories listed in Table 2.1 to come up with the range of $2,000 to $16,000.
families with more children, taxpayers who choose to buy homes (especially second houses), those who overextend on student loans, those higher-income taxpayers who benefit from the exemption for interest from municipal bonds, and others.

Third, a refundable casualty loss credit would, if implemented appropriately, provide an incentive to reduce risk taking and promote responsible behavior. Incentivizing taxpayers to fully insure and to reduce their deductibles would also likely relieve the government of some of the welfare burden it currently shoulders and transfer it to individuals themselves and the insurance industry.15

Finally, the refundable casualty loss tax credit provides a more targeted benefit for lower-income taxpayers and thus provides government assistance for those who most need it. The upside-down value provided by tax deductions and the financial benefit of non-refundable credits provide tax incentives that (i) only accrue to those with taxes remaining due after taking all other deductions and credits into consideration and (ii) provide the greatest benefit to taxpayers with the highest incomes and greatest value of assets to lose in a casualty loss. A refundable credit overcomes those limitations. The refundable Earned Income Tax Credit (EITC) has shown that refundable credits provide quick and efficient support for the working poor. If a similar refundable credit with sufficiently high phase-outs were created to offset verified net casualty losses, the credit could provide genuine support for middle- and low-income taxpayers in a time of loss who would perhaps otherwise face a significant personal financial crisis, while avoiding the substantial payouts to higher income taxpayers who are able to self-insure and are probably able to bear substantial financial losses without significant personal burdens.

B. Preventing Fraud by Verifying Losses

If there is an Achilles heel to the EITC, it is the presumed potential for fraud and abuse by those who are not actually working but pretend to do so to collect the refundable credit. Because any refundable credit provides cash payments to those who owe no taxes, there is a similar incentive for abuse with the casualty loss refundable credit proposal. One way to reduce abuses would be to coordinate the credit with insurance claims. Insurers could be required to file an information report in connection with casualty loss claims. The form would indicate the verified amount of the loss, the amount of the deductible, the amount the insurer paid to the claimant on the loss, and the amount of net casualty loss (or gain) after considering the insurance payment.

The insurance industry is already heavily regulated and has measures in place to combat insurance fraud so the addition of this reporting requirement could easily be satisfied as part of the routine insurance claim verification process. One copy of the form would be reported electronically to the IRS and another could be provided to the taxpayer so they are aware of the information that has been reported and so that they have

15 I.R.C. § 139 makes FEMA and other government relief as well as disaster relief received from nonprofit agencies, like the American Red Cross, exempt from taxation regardless of the income of the victim.
all of the information they will need to claim the credit. The form could also allow the insurance company to indicate whether the claim arose in a federally declared disaster area, which would streamline processing of the election to take the casualty loss deduction for a preceding year under section 165(i).

C. Proposed Mechanism for a $2,000 Casualty Loss Credit

Let’s consider the way a refundable casualty loss credit of $2,000 would perform. A $2,000 credit is in line with the average amount of tax relief allowed in 2008 and 2009 in connection with total casualty losses for taxpayers in all brackets earning under $200,000 AGI.16 (As noted, 2008 and 2009 were the only years when all losses in declared disaster areas escaped the 10% AGI reduction.) This should also provide a good barometer of total cost to the government because this window includes both a very high casualty-loss year and a low casualty-loss year.17 Moreover, it parallels the tax advantage most taxpayers with two children receive from the child tax credit and additional child tax credit. Although some disasters will take a larger financial toll than having two extra mouths to feed and others less, this seems an appropriate “ballpark” starting place for consideration. This also suggests a reasonable cap for the credit of $2000.

The proposed credit could be maximized for taxpayers who are insured and who carry low deductibles by having two $1,000 components: one related to the taxpayer’s deductible (“low deductible component”) and the other related to the total amount of net casualty loss (“underinsured component”). The first $1,000 component of the credit could be claimed by any taxpayer with a deductible insurance payment of up to $1,000. For example, a taxpayer with a $500 deductible would receive a $1,000 credit (rewarding the taxpayer for the low deductible), and a taxpayer with a $1,000 deductible would be entitled to a dollar-for-dollar credit. The low deductible component could be reduced by 50% of the amount by which the deductible exceeds $1,000. A taxpayer with a $2,000 deductible would then receive only a $500 credit and a taxpayer with a $3,000 deductible (or higher) would receive no “low deductible component” credit.

The second component of the credit would be determined as a declining percentage of the amount of underinsured net casualty loss. The underinsured component would reduce moral hazard because it would incentivize taxpayers to buy more adequate insurance. If everyone were fully insured, they would have no net casualty loss other than their deductible. Thus, the amount of net casualty loss approximates the extent a taxpayer is underinsured.

To discourage underinsurance, the second $1,000 component of the credit could be reduced when a taxpayer is underinsured by an unacceptable amount. The median amount of net casualty loss claimed in 2008 and 2009 for taxpayers earning under $200,000 ranges from $8,783 (2008—a high claim year with numerous federally declared disasters) to $14,650 (2009—a low claim year with fewer declared disasters) and provides a rough approximation of typical casualty losses for low- to moderate-income taxpayers. It would be reasonable to select a number on the low end, such as $10,000, as a tolerable level of underinsurance. (A lower number would further reduce the moral hazard.) A second phase-out of this underinsured component of the credit could be added for those with incomes over $200,000, to approximate the rough progressivity of the existing section 165 casualty loss scheme.

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16 Using 15% times the total amount of the deductions for all taxpayers with AGI of under $200,000 resulted in $1,317-$2,197 of tax relief for each casualty loss filer in 2008 and 2009. Calculations on file with author.

17 This statistic is calculated for the average amount of tax relieved assuming all taxpayers received the full benefit of the deduction at a 15% marginal rate (the statistics tracked by the IRS for this deduction are broken into increments based on AGI, not tax bracket, so some individuals may have been in a higher or lower bracket and some may have been unable to deduct the full amount of casualty losses because their tax obligation was less than the tax relief generated—in other words, their tax obligation may have been eliminated without need of the full advantage of the deduction).
To illustrate how the underinsured component of the credit would work, assume a $10,000 underinsurance target and a 10% credit reduction for net casualty loss amounts above this target. A taxpayer with a net casualty loss of $10,000 would receive the entire $1,000 credit. One with a lower net casualty loss would likewise receive ten-cents-on-the-dollar relief (so as not to risk overcompensating individuals with smaller loss claims). For example, a $4,000 net casualty loss would generate a credit of $400; a $9,000 loss would create a credit of $900. For those who are underinsured by more than $10,000, the credit could be ramped down at a rate of 10% of the credit per each additional thousand dollars of casualty loss. Thus, someone with a net casualty loss of $12,000 to $12,999 would receive $800 of the underinsured component of the credit, while a taxpayer with a $15,000 net casualty loss would receive only $500. This component of the credit would be reduced to zero for those with more than $20,000 of uninsured loss.

Combining the two halves of the potential $2,000 credit would generate a maximum refundable credit of $2,000 for someone carrying a $1,000 or lower deductible and suffering a verified net casualty loss of $10,000. A taxpayer with twice as much uninsured loss and the same deductible would only receive a $1,000 credit. A taxpayer with a $3,000 deductible and a casualty loss between $10,000 and $10,999 would receive a $1,000 credit.

III. The Unresolved Insurance Issue for Low-Income Taxpayers

The most common question raised about this idea is “what about people who can’t afford insurance?” The short answer is “I don’t know.” The reason I don’t know is that there are different reasons people may claim to be unable to afford insurance. It may be that a combination of low FICO scores and living in high crime areas makes auto and home insurance unaffordable for lower income people. Alternatively, people may not appreciate or may disregard the risk. Under the flood insurance program, it has been found that people not in a flood zone feel they are not at risk even though 20% of flood losses occur outside of designated 100-year flood plains. Some people may simply decide they need the money for something more important—such as a car to get back and forth to work (the most common expenditure for EITC recipients). Others may be recently unemployed: unless money is escrowed to pay home insurance, they may cut insurance protection to pay more immediate costs of food, clothing, job search, school, transportation, etc.

Likely the best starting point for consideration is the EITC itself. Eligibility for the EITC is determined based on the poverty line and what’s necessary to overcome poverty, so perhaps an insurance stipend for all EITC recipients could be paid directly to their insurance companies on behalf of these wage earners in lieu of a credit. Another option would be to increase Federal Emergency Management Agency (FEMA) direct welfare payments to disaster victims, since such FEMA payments are not taxable.

18 See, e.g., Floodsmart.gov, Understanding Your Risk. “[T]he apparent inability of the floodplain designation to effectively capture the likelihood of property damage and potential loss of human life in coastal areas has left potentially millions of property owners unaware of the flood risk and unprepared to mitigate their adverse impacts.” W.E. Highfield et al, Examining the 100-year floodplain as a metric of risk, loss, and household adjustment, National Center for Biotechnology Information (May 22, 2012).

19 Thoughts or suggestions on these issues from low-income tax clinics and practitioners who help low-income clients on a pro bono basis are welcome.
PRO BONO MATTERS

Getting to Know The Commonwealth Formerly Known as “Taxachusetts”

By Francine J. Lipman, William S. Boyd Professor of Law, University of Nevada, Las Vegas, NV

Ode to Massachusetts

“You are the heart of New England
Old Ironsides and Bunker Hill
Where JFK once paved the way
To the day the world stood still
Your One By Land and Two By Sea
Helped set our country free
You can’t get better MASSACHUSETTS.”¹

Section Members Love the Fall in Massachusetts

Massachusetts is a favorite fall meeting location for the Section. Boston Metro, where 80% of the population resides, includes the state capital and the booming business center. Boston boasts beautiful, crisp autumn weather with spectacularly colorful fall foliage.² Massachusetts has a historic mass transit system, an engaged, intellectual and highly educated population, and was the center stage for the fight against taxation without representation.

Massachusetts’ Rich Tax History

The infamous Boston Tea Party, on the evening of December 16, 1773, was the culmination of a resistance movement against the Tea Act. British American colonists objected to the Tea Act passed by Parliament in 1773 because it was “taxation without representation.” Colonists believed that the Bill of Rights of 1689 established that only a Parliament representing all the British people, including the colonists, could levy permanent taxes. In every colony except Massachusetts, protesters had forced tea consignees to withdraw or return with their tea to England. In Boston, Governor Hutchinson was determined to stand with British authority and collect the tax. In response to this stalemate a group of colonial men, some disguised as Native Americans, boarded the ships and within three hours had dumped all 342 chests of tea into the bay.

¹ Excerpts from “Ode to Massachusetts,” written and composed by Joseph Falzone.
² Take a sample fall foliage Boston tour here.
In his diary the next day, December 17, John Adams prophetically described the event:

Last Night 3 Cargoes of Bohea Tea were emptied into the Sea. This Morning a Man of War sails. This is the most magnificent Movement of all. There is a Dignity, a Majesty, a Sublimity, in this last Effort of the Patriots, that I greatly admire. The People should never rise, without doing something to be remembered—something notable And striking. This Destruction of the Tea is so bold, so daring, so firm, intrepid and inflexible, and it must have so important Consequences, and so lasting, that I cant but consider it as an Epocha in History.3

Massachusetts’ Modern Tax Evolution

More than 200 years later tax was still the subject of concern in the late 1970s as Massachusetts residents endured the third highest effective individual tax rate of any state, at 13.8%, just behind Alaska (>18%) and New York (>16%). Beantowners revolted and moved to decrease property taxes in 1980 and income taxes in the late 1990s. During the almost four decades since, Massachusetts has reduced its state and local tax burden by more than 26%, ranking as the third highest reduction of all states from 1977-2013. By comparison, the average state reduction during this period was about 9%. Today Massachusetts sits in the middle of all states ranking 25th highest (or lowest) with an effective individual tax rate of 10.1% for total state and local taxes paid. The U.S. average for the same year was slightly higher at 10.4%.

Like many other state and local tax burdens, Massachusetts taxes are not borne by its residents based upon ability to pay. Instead, Massachusetts has a state and local tax burden that is regressive. Regressive taxes impose the greatest percentage of tax burden on those with the least to contribute. The lowest 20% of Massachusetts income earners suffer a 9.5% effective tax rate while the highest 20% of earners broken down into the bottom 15%, next 4%, and the top 1% of earners only bear effective tax rates of 7.6%, 7.2%, and 5.1%.

The residents and the government of Massachusetts have been working to mitigate this burden. Like many states, Massachusetts has a sales and property tax structure that is inherently regressive, but Massachusetts does not subject most clothing, prescription medicine, home energy products, or food to sales tax. As a result of its low sales tax rate of 6.25%, these exclusions, and a vibrant economy, Massachusetts has one of the lowest sales tax burdens as a percentage of residents’ income in the United States.

Effective January 1, 2016, Massachusetts’ income tax was lowered to a flat tax rate of 5.1% on income other than capital gains. Capital gains are taxed at 12%, with a 50% long-term capital gain deduction. To reduce the burden on lower-income households, the government has implemented several mechanisms to effect a progressive tax structure despite the flat tax rate. Massachusetts has relatively large personal exemptions and a “no tax status” for households with income under certain thresholds. Massachusetts residents can also deduct certain amounts of federal payroll taxes and rents paid during the year.

The state also has a nonrefundable low-income credit and a refundable state earned income tax credit (EITC) that was increased in 2016 from 15% to 23% of the federal EITC. In 2013, more than 400,000 or 13% of Massachusetts residents claimed about $130 million in state EITC and $826 million in federal EITC. In 2010, before some of the changes described above, the lowest 20% of all Massachusetts earners had an effective income tax rate of 0.2%, while the top 5% of earners bore the highest effective tax rate

burden of 4.2%. The second, third and fourth quintiles for the same tax year bore effective state income tax rates of 2.1%, 3.2%, and 3.7%.

**Massachusetts Economy and Demographics**

As a result of these and other government resources (including long-time access to affordable healthcare), Boston and Massachusetts residents can boast about the following relative state demographics.

**Health and Welfare**

- 2\textsuperscript{nd} highest health insurance coverage rate at 94%
- Lowest teen pregnancy rate of all fifty states
- 4\textsuperscript{th} lowest rate of disconnected youth at 10%
- 85% high school graduation rate, ranking 17\textsuperscript{th} among all the states
- 2\textsuperscript{nd} highest rate of higher education attainment
- 5.8% unemployment rate, ranking 22\textsuperscript{nd} among all the states
- Rate of pay for women at 81.9 cents for every dollar that men earn, ranking 14\textsuperscript{th} among states
- 2\textsuperscript{nd} highest rate of food security at 90%
- 4\textsuperscript{th} lowest usage of high cost loans at only 4.2%

**Poverty (Official Poverty Rate)**

- 11.6% of all state residents live in poverty, ranking as the 10\textsuperscript{th} lowest state
- 14.9% of all children live in poverty, ranking as the 9\textsuperscript{th} lowest state
- 12.4% of all working age women live in poverty, ranking as the 8\textsuperscript{th} lowest state

Unfortunately, like many other states, Massachusetts continues to have much higher rates of poverty for people of color than for their white counterparts, including African Americans (21.8%), Asian Americans (14%), Hispanics (30.6%) and Native Americans (23.6%).

Unfortunately, like many vibrant state economies, housing is expensive in Massachusetts and as a result, only 62 affordable housing units are available for every 100 tenants. This ranks Massachusetts 29\textsuperscript{th} for affordable housing among all states. Income inequality is similarly high with the top 20% of all households receiving 18.5 times the income of the lowest 20% of all households. Massachusetts ranks 48\textsuperscript{th} out of 50 states for income equality.

As noted above the residents and government of Massachusetts continue to work together on their economy and tax systems to mitigate inequality and poverty. Notably, Massachusetts has been gradually increasing the hourly minimum wage, moving from $8 in 2014 and $9 in 2015, to $10 in 2016: it is also scheduled to increase to $11.00 on January 1, 2017. Massachusetts has a special minimum wage rate for agricultural workers (currently only $8 per hour), unless the worker is 17 years old or an employer’s immediate family member. Minimum wage for service employees (tipped employees receiving more than $20 per month in tips) is $3.35 per hour, increasing to $3.75 per hour as of January 1, 2017.
More Interesting Massachusetts Firsts and Factoids

As the Section understands, Massachusetts is a fascinating and historically rich state with many notable firsts. Harvard was the first college in North America; Boston Commons was the first public park; and Massachusetts built the first subway and first Dunkin Donuts. Massachusetts also had the first U.S. Postal zip code; railroad with commuter fares; elementary school; sewing machine and Thanksgiving. Four U.S. Presidents—John Adams, John Quincy Adams, John F. Kennedy, and George H.W. Bush—were born in Massachusetts. And, of course, next time you join the Section in Boston please indulge in the state dessert with a piece of Boston crème pie and reflect upon Massachusetts’ rich history.
PATHS IN TAX

C. David Anderson on Stress in Tax Practice

By Matthew Sontag, Tax Manager, RSM US, LLP, McLean, VA

Editor’s Note: This edition of Paths in Tax changes course slightly to address a topic of perennial, albeit muted, concern within the tax bar—emotional health and anxiety management. Our featured member, solo practitioner C. David Anderson, articulates our collective challenge in a new way. He then provides useful advice to mitigate damage that may be done to emotional health in the course of practicing our chosen profession.

A Lawyer’s Job Creates Stress

The work of pioneering lawyers-turned-psychologists, such as Professor Joseph Bankman at Stanford Law, has clearly shown the profound impact that the legal education system has on emotional health. An estimated one-third of lawyers face significant depression or substance abuse problems, among the highest percentage facing mental health issues for all professions.

Bankman and others have also proposed various solutions to these emotional health problems, and those solutions are slowly gaining traction. Building on this new scholarship, David Anderson draws our attention to the unique characteristics of tax law that may disproportionately trigger stress mechanisms, particularly for new practitioners. Without doubt a tax lawyer’s unhealthy relationship with cortisol, one of the key hormonal stress markers, starts like every lawyer’s—in our first year of law school. It escalates through our first federal income tax course and continues to grow as we dive into those upper-level tax courses. It doesn’t stop there, because the uniquely demanding challenges of tax practice continue throughout our careers.

Anderson primarily attributes our collective battle with stress to the sheer complexity of the tax law. It is both very detailed and very broad and, somewhat unusually among legal fields, tax is something that even a good lawyer may get completely wrong. Tax complexity is compounded by the frequency of change in the tax law; there is no end to our learning process. While this is a key attraction of the profession, it nevertheless creates constant uncertainty that can drive anxiety. Anderson also notes the surprising variability of tax knowledge even among extremely smart outsiders, meaning we function more on our own, professionally, compared to other attorneys’ who practice in an area of law that is more accessible to their legal peers and to non-lawyers. This potent mix of ambiguity and isolation regularly produces situations where we can craft reasonable, well-articulated arguments, readily accepted by our colleagues, that just happen to be wholly
Anderson primarily attributes our collective battle with stress to the sheer complexity of the tax law. It is both very detailed and very broad and, somewhat unusually among legal fields, tax is something that even a good lawyer may get completely wrong. Tax complexity is compounded by the frequency of change in the tax law; there is no end to our learning process.

incorrect. That risk weighs on us. Just as homeowners sometimes sit bolt upright in the middle of the night suddenly panicked about a leaking showerhead, so too we tax lawyers wake up to rethink our conclusions from the day before.

Unfortunately, this analogy leads directly to Anderson’s second key point. While a showerhead has a black and white answer—it’s either leaking or it isn’t—tax isn’t so kind. The further we advance in our careers, and the more others rely on our opinions, the less often we find clear answers. Our world loses what black and white it had to become endless shades of grey. Recognizing that loss of clarity only compounds our stresses.

In Anderson’s experience, the inherent predisposition to stress in our field is exacerbated by the regularity with which professional practice throws brilliant but inexperienced attorneys directly into the deep end, especially in transactional and financial institution practices. The great trust placed in tax professionals by their colleagues and clients can become ruinous pressure for early-career practitioners. Business lawyers have a habit of saying things like “just tell me whether it works for tax purposes.” Our active imaginations—such a strength in our industry—can transform into a liability as we overanalyze every single component of a question.

Anderson also points out that we are regularly left with only our own carefully constructed conclusions, often lacking a non-judgmental mentor, colleague, or even subordinate to whom to turn for a second opinion. The potential for professional isolation is particularly challenging given the constantly changing tax landscape. Large sections of our experience, which in other fields would produce a reasonably reliable and constant foundation of knowledge, come undone under the force of frequent legislative and regulatory change. Months spent analyzing a particular topic can unravel at the stroke of a pen—an unraveling that we might, under the pressures to produce, fail to recognize before delivering the advice.

Anderson concludes that these factors converge to produce a profession with a 20-40 year learning curve before we can truly “trust our gut.” Getting there takes forever, and in the meantime, there is little room for “winging it.”

Addressing the Challenge from Within

Anderson suggests techniques we can use to address our challenges. The most effective way to mitigate stress is to avoid it when possible. The first step is to know our clients. It is vital to learn quickly that unfamiliar people might be dishonest. Taking time to really understand those seeking our input—whether from outside our firm or colleagues within our own work environment—can provide valuable insights that will help us steer clear of stressful situations.

Second, Anderson reminds us to respect the different levels of tax knowledge outsiders have, even extraordinarily intelligent ones. Often these individuals don’t understand the importance of information they
haven't provided or even that they don't understand what we have told them. It falls to us to confirm their understanding. Anderson likes to borrow a technique from a good friend, a minister who regularly illustrates his points through stories and parables. In its tried-and-true way, this approach allows a potentially difficult topic to be simplified into an everyday situation, readily available to the listener. The key is to add a post-story quiz: always ask listeners to repeat back, in their own words, the primary lesson. By confirming that the audience understood well enough to restate the main point, we ensure that we have communicated well.

Third, Anderson recommends focusing on the relevance of a given analysis—are we looking at an issue that exists now, or one that may arise twenty years down the road (or never)? He remembers a fascinating lunch conversation around the (then) newly enacted section 83(b). Questions raised would not attain practical importance for over a decade, and certainly did not need deep exploration at the time. There was thus no reason for that discussion to create stress.

On the flip side, Anderson emphasizes the importance of awareness of the rate of change in the tax landscape, particularly as a marker of needed focus. Ideas have a way of expanding exponentially, so a few whispers may soon become a chorus. The way that a transaction is viewed can evolve significantly over the course of time, for better or for worse. Careful “thought triage” at the outset can ensure that we remain focused on the right areas at the right time.

Inevitably, however, we will find ourselves having to make a tough call, and no amount of explaining or planning will eliminate the risk of anxiety. Anderson’s best recommendation here is to build up a rolodex of nonjudgmental allies to whom we can turn for assistance. In many cases, the key differentiator for professional success is the presence of a trusted mentor.

Also, we need to listen to common sense. One of Anderson’s favorite aphorisms, picked up from his former wife, is that “laws are condensed common sense.” He puts an additional spin on the phrase, advising that if the answer doesn’t seem right or fair, we should keep digging, because “it’s not about the rules, it’s about the facts.” When all is said and done, tax law often reaches an answer supported by common sense. If we haven't gotten there yet, we probably need to keep working.

Despite our best efforts, however, anxiety will catch up to us when the unavoidable happens. We will make a mistake. There is no use pretending it won’t happen—it will. The only solution is to find mechanisms for dealing with the repercussions. First and foremost, Anderson advises thinking through the consequences and working out the worst that can happen. As Anderson says, “we are not going to die as a result of a mistake, and ultimately everything else can be dealt with.”

Second, as Bankman suggests, we should think about what we would tell our best friends who found themselves in similar situations, and then tell that to ourselves. Better yet, we should actually talk to our best friends, and let them tell it to us.

Also, it’s worth considering how to respond when someone else makes a mistake. Of course, the mistake should be pointed out and corrected: we really cannot do otherwise. Anderson’s advice is to approach the situation gently. It helps to remember that the next time it could be us making the mistake.
Moving Beyond Self-Help

Ultimately, self-help can only do so much: we also need to help each other. First, we can leverage our direct community by sharing our struggles. As Bankman has discovered, it is cathartic to law students to realize that others face the same demons. Always be alert to the possibility of helping others. If we begin to see warning signs in a colleague, we should ask them how they are doing. Sometimes all it takes is a question to give someone permission to turn to us for help they desperately need. In particular, we should watch for situations where the expected results, given a person’s capabilities and background, don’t line up with what that person is delivering.

Second, we should seek help when we need it. Adopt a “mindfulness” or yoga practice. Many of these techniques have a sound basis in science, such as the proven ability of meditation to lower blood pressure. We should go see a professional therapist. They are trained and capable of assisting us in taking care of our emotional health.

Third, and perhaps most important for the future, we need to work within our professional organizations, whether it’s the local bar association, the state bar, the ABA Section of Taxation, or another group, to establish a network of resources for professionals struggling with emotional health challenges. These networks, such as New York City’s “match.com”-style service connecting individuals with professional resources, can be precisely the support necessary to get our colleagues the help that they need.

Anderson closes by saying that many of the struggles we face as tax professionals cannot be eliminated, so it is critical for us to address the ones that can. Until we all take proactive steps to address the problem, it will remain a perennially unspoken challenge.
IN THE STACKS

Taxation of Entertainers, Athletes, and Artists

Book Review by Luisa Andonie, University of Miami School of Law, Coral Gables, FL


Attorneys and students alike will rejoice to discover there is such a thing as a tax book that is agreeable to read. While tax practitioners may find Taxation of Entertainers, Athletes, and Artists overly basic, the rest of us will appreciate its depth and clarity. It boasts the accessibility of a study aid and the straightforwardness of a practice manual.

Lionel S. Sobel, the author, teaches a class on taxation of entertainers at UCLA and was chairman of the ABA Forum on the Entertainment and Sports Industries. He manages to break down complexities into comprehensible dialogue, separating topics neatly into 14 chapters for ease of reference. He says he “strived to make this book as easy to read as a book about tax can be.”

Simple does not mean simplistic. The first part of the book explores domestic treatment, while the second plunges into the complexities of international taxation. It addresses the taxation of income earned in the U.S. by nonresident alien entertainers, as well as other countries’ treatment of domestic income earned by U.S. citizen and U.S. resident-alien entertainers. The book then explores possible relief the U.S. makes available for both citizens and resident aliens in the U.S. when they pay tax in other countries.

Throughout this in-depth exploration, Sobel writes in a humorous tone, quoting Mark Twain and translating the tax court’s stance into colloquial language. His avoidance of legalese makes tax jargon accessible to readers of varied academic and professional backgrounds. Throughout the detailed analysis, he offers insightful commentary—such as “it’s surprising how little published law there is on this issue”—as though he were a friendly tour guide.

Employing contractions and well-placed humor, his informal writing style lends the book a dinner conversation tone. Nonetheless, he maintains scholarly accuracy with citations to IRS revenue rulings and similar sources. Of particular
value, he translates the IRS's examples into illustrations that omit the complexities, where appropriate, to provide explanation.

Unlike textbooks, which often focus on theories, Sobel presents issues with a pragmatic, answer-seeking approach. By laying out issues in the practical client context in which they may arise, he provides aspiring and established entertainment lawyers a closer understanding of fundamental tax statutes. Similarly, he defines terminology with simple examples, providing non-tax lawyers the ability to recognize tax issues and be able to refer clients to a tax specialist.

The book covers the essential principles and cases taught in an introductory income tax course, making it a study tool for students currently taking even non-entertainment tax courses. Like a study outline, it synthesizes factors into readable bullet points. After each concept, there are examples making it comparable to the Examples and Explanations series. At the beginning of each chapter, there is an outline of the subheadings within the chapter.

Unlike a black letter law study aid, the book provides precise footnotes to the Internal Revenue Code, Treasury Regulations, and cases, as well as IRS guidelines and news releases, making it a good starting point for further research.

Even the physical design of the book prioritizes the reader, with a large font size, clean formatting, and paperback portability. At fewer than 400 pages and smaller than a textbook, it is not a dust-gathering tome. Indeed, interspersed with flow charts, tables, and tax form images, the book is a reliable reference just as much as an engaging guidebook.

The book is available for purchase on the ABA Website.
IN THE STACKS

Call for Book Reviews

The move to a digital-only format has allowed ATT to expand the types of materials we publish. One new feature is reviews of books and articles on topics of interest to our members. Reviews inform readers of recent publications pertaining to tax policy and emerging issues, as well as broader concerns about the interrelationship between tax policies and economic growth, income inequality and poverty. Reviews may be of single books or articles or they may be review essays that discuss and compare two or more books and articles addressing the same topic, similar to such review essays in the New York Review of Books. Reviews will be considered for publication in each issue of ATT.

Reviews should be no more than 2,000 words in length, though on rare occasions longer submissions will be accepted on consultation with the editor. Reviews should provide a concise introduction to the item’s primary themes and a critical analysis of its significance that considers strengths, weaknesses, and relevance to the field.

Here is an eclectic sampling of titles in our stacks for which ATT will consider a review.


Beginner’s Guide to Tax-Exempt Bonds for Affordable Housing, Alysse Hollis & Richard M. Froehlich (ABA 2016)

Business, Human Rights, and Sustainability Sourcebook, ed. Lelia Mooney (ABA 2016)

Carbon Pricing, ed. Larry Kreiser et al. (Edward Elgar 2016)


Economic Behaviour and Taxation, James Alm & J.Sebastian Leguizamón (Edward Elgar 2016)

Environmental Pricing, ed. Larry Kreiser et al. (Edward Elgar 2016)

Judicial Interpretation of Tax Treaties, Carlo Garbarino & Emile Noël Fellow (Edward Elgar Publishing 2016)

Social Security Law, Policy, and Practice, Frank Bloch & Jon Dubin (West Academic Publishing 2016)


If you are interested in submitting a review of any of these titles or in discussing other content ideas for ATT, contact Supervising Editor, Linda M. Beale at lbeale@wayne.edu.
Attending an ABA Tax Section Meeting as a Young Lawyer

By Shawn McIntire, Ballard Spahr LLP, Denver, CO

Attending an ABA Tax Section meeting can be intimidating for a law student or young lawyer. Many of the attorneys you meet were at the forefront in developing and substantiating legal principles you studied in law school. Although many of the substantive panels may seem beyond your practice, the ABA Tax Section’s Young Lawyers Forum (YLF) is dedicated to bridging the gap between new attorneys and seasoned professionals. This article provides a glimpse into the different YLF activities at Tax Section meetings and throughout the year, focusing specifically on YLF panels at the most recent Fall meeting in Boston.

Tax Bridge to Practice

Tax Bridge to Practice is a series of panels that kick off the Tax Section’s meeting on Thursday afternoon before the main sessions begin. As the name indicates, Tax Bridge to Practice focuses on issues that young lawyers will face in practice. Often the panels will discuss the tax provisions applicable to a particular issue, giving the attendees an opportunity to understand the basic framework that might not otherwise be covered in committee panels. The Tax Bridge program is generally presented during the May Meeting in Washington, D.C.; however, occasionally the YLF presents a “Tax Bridge on the Road” at the Midyear or Fall Meeting. The Boston meeting offered five panels in the Tax Bridge, as well as a special conversation with Nina Olson, the National Taxpayer Advocate.

Intersection of Sports and Tax Law – This panel discussed the federal and state tax laws affecting sports franchises and players. The panelists provided insight for attorneys representing professional athletes on a variety of issues, including state domicile and residency.

Tax Court 101: Pre-Trial Tips & Best Practices – As with many of the Tax Bridge panels, this panel provided a basic breakdown of Tax Court procedures with practical tips for any new lawyer in this practice area.

Basics & Hot Topics: RICs and REITs – The panelists discussed regulated investment companies (RICs) and real estate investment trusts (REITs) under subchapter M, addressing the purpose of RICs and REITs, the qualification requirements for REITs and RICs, and the taxation of both entities and their investors.

Same-Sex Estate Planning After Obergefell v. Hodges – George Karibjianian from Proskauer Rose and Laura Westfall from King & Spalding examined the various theoretical, procedural, and practical considerations that come into play in same-sex estate planning. The panelists addressed topics such as asset protection, the differences between domestic partnership and marriage, and state law issues.
Hot Topic: Tax Implications of the Sharing Economy – This panel discussed the growing complexity of tax issues arising in online transactions. Given the rapid expansion in online transactions, both in terms of quantity and type, the IRS and state taxing authorities have focused on interpreting current laws and developing regulations to deal with these new business structures and cover this growing portion of our economy.

YLF and Diversity Panels

In addition to the Tax Bridge, the YLF hosts at least one substantive panel each Section meeting. Often the YLF and Diversity Committee offer joint panels. In Boston, Cathy Fung of the IRS Chief Counsel’s office led a panel called On the Road to Success: What You Don’t Learn in Law School which featured a panel of junior and mid-level attorneys. They provided their perspectives on finding their first legal positions after law school, learning the ropes in those positions, and excelling in their first legal jobs and beyond. The panelists discussed their experiences in large and mid-size law firms, government, accounting firms, clerkships, and low-income taxpayer clinics.

YLF Panel on Legal Incubators

Immediate past YLF Chair Anne-Marie Rabago brought together a panel of practitioners in Legal Incubators: What Are They and How Can They Impact My Practice? This panel, comprised of individuals on the forefront of the legal incubator movement, discussed the emergence of incubators and residency programs across the country. These incubators benefit newly-admitted lawyers, experienced practitioners, and the communities in which they are located by providing low-cost legal services through cost sharing among a group of less experienced attorneys.

YLF and Diversity Reception

At the conclusion of the Friday sessions, the YLF and Diversity Committee host a reception that is open to all Tax Sections members. Many more senior members attend, providing an opportunity for young lawyers to mingle with experienced Section members in a casual setting. This event is a mainstay in every Tax Section meeting.

Other YLF Projects

One of the YLF’s most important projects is organizing the annual Law Student Tax Challenge. This is the 16th year of the competition, which provides an opportunity for J.D. and LL.M. students to compete in preparing a mock research project. Some teams will be selected to present to a panel of distinguished tax professionals and Tax Court judges at the finals. The competition is run solely by YLF members. Work on the competition spans the entire year with planning, development, grading, and organizing the oral round of finals at the Midyear meeting.

The YLF is also a gateway to the other Tax Section committees. It acts as a liaison to place many of its members in substantive committees through participation in panels and research projects.

If you are interested in becoming involved in the YLF or participating on a future panel or in the Law Student Tax Challenge, please contact Shawn McIntire at mcintires@ballardspahr.com for more information.
Election Fever Reruns

By Robert S. Steinberg, Law Offices of Robert S. Steinberg, Palmetto Bay, FL

Let’s Call the Whole Thing Off

(To the tune of “Let’s Call the Whole Thing Off,” by George and Ira Gershwin.)

Intro
Things have come to a great impasse
And the blame flies “tit for tat”
The Republicans want one thing
But the Democrats don’t want that
Oh I fear a sad end we’ll see
Will democracy fall flat?
This great nation born, no longer one
Something must be done.

Verse
You’d cut spending with budget axes
I’d trim spending and edge up taxes
Spending, taxes, budget axes
Let’s call the whole thing off.

I say public and you say private
You’d kill health care and I’d revive it
Public, private, kill, revive it
Let’s call the whole thing off.

Bridge
Although, if we call the whole thing off
Then we might start to think
And so, given proper thought
We might do what we ought.

You Can’t Take That Away

(To the tune of “They Can’t Take That Away” by George and Ira Gershwin.)

Intro
There’ve been many goodies added to the tax code as it grew
Here are some that we’ve become addicted to.

Verse
The 401 sub-(k)
The corporate R&D
You want to take away?
No, no, you can’t take that away from me.

Home mortgage interest prized
By every family
Think of that home downsized
No, no, you can’t take that away from me.

Verse
Stop pretending to grind no axes
Fed-up, knowing
To hell the country’s going,
The people call the politics off
Let’s call the whole thing off.

Bridge
We can’t solve the budgetary crisis
We’ve grown wary of
Lest we all give up some tax breaks dearly loved.

Verse
My contributions for
The art of Johns or Klee
Allowed not anymore?
No, no, you can’t take that away from me.

The rate on long term gains
Health benefits tax free
The lobbyist complains
No, no, you can’t take that away from me.

You can’t take that away
More campaign cash I’ll pay
You can’t take that away from me.
SECTION NEWS

Government Submissions Boxscore

Since January 1, 2016, the Section has coordinated the following government submissions, which can be viewed and downloaded free of charge from the Section’s website at [http://www.americanbar.org/groups/taxation/policy.html](http://www.americanbar.org/groups/taxation/policy.html).

**SUBMISSIONS AND COMMENTS ON GOVERNMENT REGULATIONS, ADMINISTRATIVE RULINGS, BLANKET AUTHORITY and ABA POLICY**

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SECTION NEWS

Section Testimony Before the U.S. House of Representatives Committee on Small Business

By Jesse Tsai, Staff Counsel, ABA Section of Taxation, Washington, DC

On September 14, 2016, the House Committee on Small Business met to discuss the IRS examination process as it pertains to small businesses. Ms. Jennifer E. Breen, vice chair of the Administrative Practice Committee, represented the Section of Taxation at the hearing. Ms. Breen provided insight into the examination process, including how the IRS’s Small Business/Self-Employed Division selects audit candidates, what are the typical audit procedures, and how examinations are concluded. A video recording and written copy of Ms. Breen’s testimony are available below.
ANNOUNCEMENTS

Accepting Nominations for the 2017 Nolan Fellowships

Named for the late Jack Nolan, a dedicated and respected Tax Section member, the Nolan Fellow distinction is awarded to young lawyers who are actively involved in the Section and have shown leadership qualities. Each one-year fellowship includes waived Meeting registration fees and assistance with travel to some Section meetings.

The deadline for nominations for the 2017 Nolan Fellowships is December 9, 2016. Visit the Nolan Fellowships page on the website for more information about the award criteria and to download the nomination form.

Accepting Nominations for the 2017 Janet Spragens Pro Bono Award

The Pro Bono Award Committee is pleased to announce that it is currently accepting nominations for the 2017 Janet Spragens Pro Bono Award. The award will be announced on January 21 at the Plenary Luncheon at the 2017 Midyear Meeting in Orlando, FL.

Established in 2002 to recognize outstanding and sustained achievements in pro bono activities in tax law, the award was renamed in 2007 in honor of the late Janet Spragens. Janet received the award in 2006 in recognition of her dedication to the development of low income taxpayer clinics throughout the United States. The Section is proud to honor Janet by recognizing the outstanding pro bono contributions of our members through this award.

For more information about this award and prior award recipients, go to: www.americanbar.org/groups/taxation/awards/probono.html.

Please send nominations to Derek B. Wagner at derek.wagner@americanbar.org. The deadline to submit nominations is Friday, November 18, 2016. All nominations will be held in confidence by the committee.

Choose the TAPS Endowment for Your Year-End Giving

Through the Tax Assistance Public Service (TAPS) endowment fund, the Section of Taxation seeks to provide stable, long-term funding for its tax-related public service programs. The TAPS endowment fund will primarily support the Christine A. Brunswick Public Service Fellowship program. The Public Service Fellowship program provides two-year fellowships for recent law school graduates working for non-profit organizations offering tax-related legal assistance to underserved communities. Consider giving to the TAPS endowment fund today. Your generous support will help ensure that the Section can continue its mission to provide legal assistance to those in need.
The Tax Lawyer – Summer 2016 Issue Is Now Available

The Summer 2016 Issue of The Tax Lawyer, the nation's premier, peer-reviewed tax law journal, is now available. The Tax Lawyer is published quarterly as a service to members of the Tax Section. Click here to read or download the complete issue.

Report

American Bar Association Section of Taxation, Comments on the Multistate Tax Commission's Proposed Draft Amendments to Its Model General Allocation and Apportionment Regulations

Articles

Bruce J. Squillante, Temple-Inland—Revealing How the States Moved From Jackrabbits to Predators in Taking Unclaimed Property

Moon J. Koo, Is the Investment Tax Credit Really More Coercive Than the Personal Property Tax Exemption in the Cuno Controversy?

New York Program Committee on State and Local Taxes, Discussion of First Interim Report of the Special Subcommittee on State Taxation of Interstate Commerce

Index

Volume 69, Numbers 1, 2, 3, and 4

Comment

Alexandra K. Langton, The Inconsistent Limits of the Commerce and Import-Export Clauses on Territorial Governments’ Taxing Ability

Note

Brandon Finz, Uncertainty Will Persist: Perpetuating the Battle Over Natural Gas Taxation Through an Analysis of Missouri Gas v. Kansas Division of Property Valuation
The Practical Tax Lawyer – Fall 2016 Issue Is Now Available

Produced in cooperation with the Tax Section and published by ALI-CLE, The Practical Tax Lawyer offers concise, practice-oriented articles to assist lawyers with all aspects of tax law. The articles are written by practitioners and are reviewed by an expert board of editorial advisors who are members of the ABA Tax Section and are appointed by the Section. Published four times yearly, each issue of The Practical Tax Lawyer brings you pragmatic, nuts-and-bolts advice on how to solve your clients’ tax problems. The Fall 2016 issue features the following articles:

Barbara T. Kaplan, Procedures and Strategies for Resolving Cases at Exam (Part 2)

Blake D. Rubin, Andrea M. Whiteway, & Jon G. Finkelstein, Put a “Bottom” Deficit Restoration Obligation in Your Partnership Liability Allocation Tool Box

Wm. Robert (“Bob”) Pope, Jr. & Frank Agostino, Resolving Federal Tax Claims in Bankruptcy: The “Intentional” Tax Bankruptcy Discharge and Litigation (with Checklist)

Ted David, Learn to Love the IRS:
  - Time’s Up! Statutes of Limitations in Tax Cases
  - Have a Heart?
  - Non-Filer’s Tax Hell
  - Whistle While You Work
  - Lawyer, Car Guy, Unsophisticated but “Businesslike”
  - Squeezing the Apple
  - Average Deduction?

Tax Section members are entitled to a subscription discount. For more information, visit PTL’s webpage: https://www.ali-cle.org/index.cfm?fuseaction=publications.periodical&pub=PTL.

Get Involved in ATT

ABA Tax Times (ATT) is looking for volunteers to join its ranks as associate editors to assist in writing and acquiring articles for publication. This opportunity is open to Section members with significant writing or publication experience, a genuine interest in helping ATT attract great content, and a willingness to commit to at least one article a year. You can find more information about our submission guidelines here. If you are interested in a regular writing and editing opportunity with ATT, contact Linda M. Beale, Supervising Editor, at lbeale@wayne.edu.
SECTION EVENTS & PROMOTIONS

ABA Section of Taxation Meeting Calendar

www.americanbar.org/groups/taxation/events_cle.html

ABA Tax Section meetings are a great way to get connected, get educated, and get the most from your membership! Join us for CLE programming and the latest news and updates from Capitol Hill, the IRS, Treasury and other federal agencies.

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<td>JOINT FALL CLE MEETING</td>
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<td>MIDYEAR MEETING</td>
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<td>MAY MEETING</td>
<td>Grand Hyatt, Washington, DC</td>
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<td>October 4-6, 2018</td>
<td>JOINT FALL CLE MEETING</td>
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If You Missed the Last Section Meeting

Materials / TaxIQ

View and search hundreds of materials submitted for the Section's Fall, Midyear, and May Meetings on TaxIQ and Westlaw. This member service is made possible by Thomson Reuters—a publishing sponsor of the Section of Taxation. For more information, go to the TaxIQ page on the website.

Recordings

Audio recordings of CLE programs from recent Tax Section Meetings are available from Digital Conference Providers (DCP), the Section’s audio service provider. Orders can be placed through the DCP website at https://www.dcporder.com/abatx/ or by calling 630/963-8311.

Online CLE from West LegalEd

The ABA is a content partner with Thomson Reuters, and many programs presented at the Tax Section’s Fall, Midyear, and May Meetings are subsequently made available through the Thomson Reuters West LegalEd Center. For more information, go to http://westlegaledcenter.com.
## SECTION EVENTS & PROMOTIONS

### ABA Section of Taxation CLE Calendar

[www.americanbar.org/groups/taxation/events_cle.html](http://www.americanbar.org/groups/taxation/events_cle.html)

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<td>A Conversation with Caroline Ciraolo</td>
<td>Tax Section 202.662.8670</td>
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<td>November 16, 2016</td>
<td>Tax Tales: Seminal Cases of Subchapter C</td>
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<td>December 13, 2016</td>
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<td>December 15, 2016</td>
<td>Ethical Considerations for the Employee Benefits Practitioner</td>
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<td>January 4-8, 2017</td>
<td>34th Annual National CLE Conference – “CLE &amp; Ski!”</td>
<td>CLE in Colorado Inc. 888.860.2531</td>
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<td>Snowmass, CO</td>
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<td>Cosponsored by the Colorado Bar Association and the Law Education Institute</td>
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<td>The Ritz-Carlton, New Orleans, LA</td>
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<td>April 5-7, 2017</td>
<td>17th Annual Tax Planning Strategies – U.S. and Europe</td>
<td>Tax Section 202.662.8670</td>
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<td>Hotel Arts, Barcelona, Spain</td>
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<td>MAY MEETING</td>
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ABA Section of Taxation CLE Products

Listen at your convenience to high-quality tax law CLE on a variety of topics, including: Affordable Care Act implementation, new Circular 230 rules, partnerships and S corporations, recent legislation, ethics, international tax planning, and more. ABA CLE downloads are generally accepted in the following MCLE jurisdictions: AK, AR, CA, CO, GA, HI, IL, MO, MT, NV, NM, NY, ND, OR, TX, UT, VT, WV. Recordings and course materials from the following recent Tax Section webinars and more are available through the ABA Web Store.

Holding Company Jurisdictions for Investments in Latin America - What You Need To Know Now
BEPS and Transfer Pricing Implications for State and Local Tax
Data Security, Client Confidences and Ethics Rules Applicable to the Protection of Client Information
Turning the Tables: The United States as a Tax Haven Destination
Civil and Criminal Employment Tax Enforcement Efforts – Employers Beware
The Nuts and Bolts of REITs
Ethical Issues in Setting Engagement Terms
Current Developments in Individual, Corporate, Partnership and Estate & Gift Taxation
The Administrative Tax Controversy Case from Examination to Appeals
The Nuts and Bolts of the Taxation of Mergers and Acquisitions
Responding to the Repeal of TEFRA
A New Era in Taxation of Derivatives
Basics of IRS Collection Alternatives
State Income, Double Taxation, and Tax Discrimination in the Post-Wynne World
Current Issues for Private Investment Funds and Their Managers
Designing a Pro Bono Project for Your Firm
Reading and Understanding a Partnership Agreement
Top Ten Revenue Rulings for Estate Planners
Affordable Care Act Implementation Issues Impacting Individuals and Families
Oil and Gas Tax Partnerships
Choosing Wisely: When to Use (or Not Use) Mediation to Obtain Cost Effective Closure in Exam & Collection Cases
What's a Young Tax Attorney to Do When...?
Bitcoins: What You Need To Know About Virtual Currency
Update on State Taxation of Tribal Leased Lands: The New Leasing Regulations
Going Out on Your Own and Changing Firms – Practical and Ethical Considerations
Kicking it Upstairs – How to Elevate Issues Within the IRS
Back to Basics on the Ethics of Federal Tax Practice: Best Practices 101
The Tax Consequences of the Legalization of Marijuana Inversions: New Rules, Continued Challenges
Tax Issues Arising from Tax Sharing Agreements (Part I)
Tax Issues Arising from Tax Sharing Agreements (Part II)
SECTION EVENTS & PROMOTIONS

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- 25% come from firms of over 100 attorneys
- 23% come from firms of 1-20 attorneys

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<tr>
<td>March 16–18, 2017</td>
<td>16TH ANNUAL TAX PLANNING STRATEGIES – U.S. AND EUROPE</td>
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For additional information on the above conferences or any of our other conferences, please visit http://www.americanbar.org/groups/taxation/sponsorship.html or contact our Sponsorship Team at taxmem@americanbar.org or at 202/662-8680.
Now Available!
New Editions of the ABA Section of Taxation State & Local Tax Deskbooks

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Did you know that Tax Section members have access to thousands of pages of cutting-edge committee program materials presented at Section of Taxation Meetings?

TaxIQ is a Section-hosted static database of meeting materials organized by Section Meeting and Committee name. This index is useful to members who attended a past meeting or want to research materials from a specific committee.

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